FORMATION AND OPERATION
OF JOINT VENTURES
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FORMATION AND MANAGEMENT OF JOINT VENTURES IN CANADA

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CHAPTER 1

INTRODUCTION AND OVERVIEW

Little has been written on the practical aspects of forming and managing joint ventures, particularly within the Canadian context. Therefore, the objective of this study was to provide a set of practical guidelines associated with the formation and management of successful joint ventures in Canada. The guidelines are intended principally for executives with either limited or no prior experience with joint ventures, and are primarily oriented toward ventures in manufacturing industries.

RESEARCH METHOD

Personal interviews were conducted with over 80 senior executives from more than 50 different Canadian joint ventures that were formed and managed during the 1980s. Managers were sought from parent companies as well as from the joint ventures themselves in order to provide a thorough understanding of the critical issues associated with successful formation and management of these ventures. Interview data were supplemented with a variety of information obtained from questionnaires and other sources. Additional information was collected from the executives regarding nearly 100 other joint ventures which their firms had participated in. During the interviews, we extensively discussed the executives' experiences, both successful and unsuccessful, in forming and managing joint ventures in Canada. Furthermore, in order to promote candid and honest responses, all participants were guaranteed anonymity. As a result, the participating executives spoke openly about not only their firms' successes, but also about the poor judgement, mismanagement, and a wide variety of unanticipated events which had characterized their firms' joint venture experiences.

OVERVIEW OF THE BOOK

This document attempts to provide a practical overview of our study's findings. The emphasis is on providing a broad and useful set of guidelines to serve as a starting point for forming and managing joint ventures. However, it was evident from our interviews that each venture is unique in its own way. Thus, we have frequently found it difficult or impossible to generalize from the experiences of others and provide recommendations for the "one right way" to do things. Rather, the "best" way is the one which is appropriate for the individual firm's own unique circumstances. Despite this caveat, we believe that there <u>are</u> a number of key factors which are closely linked to the ability of companies to successfully form and manage joint ventures in Canada, and many of these factors have been successfully captured within the chapters which follow.

Chapter 2 addresses the issue of why firms should consider forming joint ventures. Trends in joint venture activity are discussed, as well as the benefits and drawbacks of these ventures. Chapter 3 addresses the importance of finding the "right" partner, and identifies key issues associated with the identification and evaluation of suitable partner prospects. Issues associated with the negotiation of joint venture agreements are discussed in

Chapter 4, including strategic, operational, legal, financial and tax considerations relevant to the agreement. Chapter 5 focuses on critical decisions associated with ownership and control of the joint venture. The importance of effective control to parent and joint venture performance is discussed, as well as the dimensions which comprise effective control efforts. Chapter 6 discusses issues associated with management of a joint venture, including management of human resources, parent-joint venture relations, and management of the venture throughout the various stages of its life cycle, including termination. The last chapter, Chapter 7, provides several concluding comments regarding this study and the overall phenomenon of joint ventures, including a review of requirements for successfully forming and managing these ventures.

CHAPTER 2

WHY CONSIDER FORMING A JOINT VENTURE?

This document examines the formation and management of joint ventures in Canada. The term joint venture refers to those ventures which involve two or more legally distinct organizations (the parents), each of which actively participates in the decision making activities of their jointly owned entity. Joint ventures are typically formed to combine complementary skills and resources of the parent firms in an effort to achieve specific, though sometimes different, strategic goals. However, the Canadian legal system provides great flexibility and imposes few restrictions regarding the form which these ventures may take.

An alternative to such investment options as licensing or wholly-owned subsidiaries, joint ventures were traditionally viewed by most firms as a sign of weakness. Particularly within a parent's core businesses, collaboration was something to avoid whenever possible. However, these ventures have become a basic fact of life for many Canadian managers during the 1980s. Although still a relatively small percentage of overall business activity, the frequency of these ventures has exhibited explosive growth in recent years both in Canada and elsewhere. In fact, at the end of 1988, there were over 3200 joint ventures in existence in Canada.(1) As shown in Table 1, these ventures occurred in virtually every industrial sector. They also involved firms of all types - large and small, public and private, domestic and foreign.

In addition to their frequency, joint ventures have become an increasing concern for Canadian managers because of their strategic orientation. Traditionally, most of these ventures were formed by firms in order to exploit peripheral technologies or markets. However, an increasing proportion of the ventures formed during the 1980s involve products, markets or technologies closely related to the parents' strategically critical "core" activities. For example, at the end of 1988, over 98 percent of the joint ventures in Canada involved 2 or more parent firms from the same industry, and over 85 percent of these ventures were also in the same industry as their parents.

Furthermore, the incidence of joint ventures and other forms of cooperative activity is likely to increase even further as we continue toward the 21st century. There are a number of reasons for these trends. First, fueled by such developments as the Canada-U.S. Free Trade Agreement, the emergence of an economically unified Western European market after 1992 and rapid economic development along the Pacific Rim, as well as advances in communication technologies larger regional or global markets are emerging in many product/market segments. In addition, the increasing scale and complexity associated with developing new technologies and markets have made it more difficult and risky for individual companies to supply all of the skills and resources necessary to compete successfully. Furthermore, many of the traditional technological or cultural boundaries between industries - for instance, between telecommunications, computers and information services - are beginning to blur, forcing firms to learn new skills and appeal to new customers in order to survive. These risks are further intensified by the accelerating rate at which innovations and markets are being developed. These developments are transforming numerous industries by raising the

TABLE 1

CANADIAN JOINT VENTURES[1] IN EXISTENCE IN 1988
CLASSIFIED BY INDUSTRIAL SECTOR

Industry	Frequency	Percent
Agriculture, Forestry & Fishing	205	6.3
Mining	97	3.0
Manufacturing		
Food & Beverages	61	1.9
Textile & Clothing	69	2.1
Paper, Wood & Furniture	100	3.1
Metal Industries	89	2.7
Machinery & Equipment	59	1.8
Mineral, Oil & Chemical Processing	73	2.2
Other Manufacturing	110	3.4
Construction	181	5.5
Utilities	125	3.8
Wholesale Trade	377	11.5
Retail Trade	164	5.0
Finance	1,178	36.0
Services	380	11.6
TOTAL	**3,268**	**100.0%**

[1] Only includes joint ventures involving 4 or less parent companies.

SOURCE: J.M. Geringer, Trends and Traits of Canadian Joint Ventures, Ottawa: Investment Canada, 1989 (forthcoming).

competitive stakes necessary to remain in the game. As a result, for many industries, no single company can cover all the bases. An increasing number of firms are finding it necessary to join with one or more partner firms in order to remain as viable competitors. Joint ventures represent one common means of structuring these relationships, and they offer several potential benefits to firms which use them.

BENEFITS OF FORMING JOINT VENTURES

Firms form joint ventures for a number of reasons. The most common motives can be categorized as follows: 1) to gain access to new skills or resources for existing markets, 2) to gain access to new markets, 3) to achieve economies of scale, 4) to reduce risk of large or uncertain investments, 5) to co-opt or block competition, and 6) to permit orderly withdrawal from a business or market. Each of these motives is briefly described below.

1. To Gain Access to New Skills or Resources for Existing Markets

Perhaps the most common motive for pursuing a joint venture is to gain access to new skills or resources which will enhance a firm's competitive position in existing markets. These skills and resources include improved access to financing; new or improved technology; lower cost or higher quality

raw materials or components; managerial or non-managerial personnel of more appropriate quality, quantity or cost; possession of or improved access to regulatory permits or government contracts; copyrights or brand names; and additional products or services to broaden the firm's line; as well as improved access to a wide variety of skills in such areas as design and engineering, management, production, marketing, distribution and government or public relations.

2. To Gain Access to New Markets

Many firms develop products or technologies which may have strong appeal in other markets, yet find that they are unable to satisfactorily access these markets. Exporting may not permit the firm to achieve sufficient market penetration, and licensing may not yield a satisfactory financial payoff. Similarly, the firm may lack the resources or capabilities necessary to successfully enter a new market via a wholly-owned operation. In these cases, a joint venture may represent an attractive alternative for gaining access to a new market. In addition to providing new resources and skills, the presence of a joint venture partner may enable the firm to overcome trade, local content or investment barriers erected by local governments; to overcome barriers associated with nationalistic sentiments by enabling the company to become a "local" firm via partnership with a local partner; and to accelerate the rate of market penetration when rapid entry is critical and would take the firm too long to accomplish on its own.

3. To Achieve Economies of Scale

Another common motive for forming joint ventures is to increase opportunities for achieving economies of scale in manufacturing, distribution, administration, or other activities. Joint ventures can be particularly attractive for smaller firms in an industry, since the scale of the partners' combined operations may be sufficient to reduce their average costs to a level similar to those of larger competitors. The partnership may also enable the firms to afford major investments in new products or processes which would be too costly for the firms on their own. Combining operations in this manner may also help rationalize production within an industry, thus reducing overcapacity and enhancing the remaining firms' ability to compete with larger and more efficient competitors from the U.S., Europe, Japan or elsewhere.

4. To Reduce the Risk of Large or Uncertain Investments

Some projects may simply be too large or may involve too much uncertainty for a company to undertake on its own. Joint ventures may help reduce the risk of large or uncertain investments by helping to reduce or disperse the level of fixed costs associated with a particular project. For example, it is common for oil and gas as well as mining firms to be involved in a large number of different joint ventures. By building a portfolio of ventures, each firm can reduce the cost and risk associated with development of any individual site. Similarly, firms may form joint ventures to reduce the total capital investment required for a project. By combining the unique technologies or other skills or resources of each partner firm, the joint venture may be able to substantially reduce the learning costs or other barriers, as well as the development time and payback period, necessary to commercialize a product.

5. To Co-opt or Block Competition

Formation of a joint venture may also enable a firm to co-opt or block competition within a market. For example, a firm may form a defensive joint venture with an existing or potential competitor in an effort to cooperate

rather than compete with the competitor in a particular product/market segment. Similarly, a firm may participate in an offensive joint venture in an effort to increase costs and/or lower the market share for a third firm within an industry, including raising barriers to the entry of foreign competitors.

6. To Permit Orderly Withdrawal from a Business or Market

Firms may form a joint venture as an initial step in making an orderly withdrawal from a particular business or market. For example, if a market is maturing and overcapacity or limited market share threatens prospects for future profitability, the exiting firm may form a joint venture with a competitor in order to provide the latter with increased market share as well as reducing the level of capacity in the industry. Similarly, a firm may decide that the strategic attractiveness of a particular business has declined, and a joint venture may be an attractive way of gradually exiting the business without causing a major disruption to its other operations or forcing a sale at a below-market price.

The six motives discussed above capture the primary advantages associated with participation in a joint venture. Of course, it is not uncommon for firms to simultaneously pursue more than one of these motives when forming a joint venture.

DRAWBACKS OF JOINT VENTURES

Despite their potential benefits and the dramatic upsurge in their frequency and strategic importance, the use of joint ventures may also entail significant drawbacks. These ventures can be far more complex to manage than many firms initially expect. The perspective and skills necessary to successfully manage these ventures are foreign to most managers. They require executives to quickly master the subtle art of sharing power and information with another firm, without giving away too much - a difficult task indeed! As a result, these ventures have often been plagued by performance problems. A large proportion are terminated within their first few years. One study found that approximately 40 percent of all joint ventures examined had ceased operations during their first 4 years, and over 85 percent during their first 10 years.(2) In Canada, 48 percent of the joint ventures in existence in 1981 had been terminated by 1988.(3) However, even if they survive, many joint ventures are still perceived as failures. Independent studies by Coopers & Lybrand, Ernst & Whinney and McKinsey & Company suggest that as many as 70 percent or more of all joint ventures fail to satisfy the strategic objectives of one or more of their parent firms.

Many, if not most, of the performance problems experienced by joint ventures can be traced to the complexity associated with their management. Indeed, formation and management of a joint venture can represent one of the most difficult challenges which will confront an executive during his or her career. The presence of two or more parent organizations, who may be competitors as well as collaborators and who often evidence differences in national or corporate culture, frequently results in disagreement over a venture's operating objectives or procedures. Management difficulties associated with these ventures may be further exacerbated due to the need for coordination of and communication between parent firms, as well as between parents and the joint venture. The resulting conflict, decision making deadlocks, and compromises can limit the venture's ability to respond quickly and effectively to market developments. Within such an environment, it is not

surprising that parent firms' strategic objectives are often not fully achieved, and that the ventures tend to be short-lived.

These performance problems confronting joint ventures represent a critical managerial concern. Of course, formation and management of joint ventures commonly consume large quantities of management time and other scarce resources, most of which represent sunk costs if the venture is terminated. Failure of the venture can also have a negative effect on a parent firm's public image. Of even greater potential concern, difficulties in effectively controlling a joint venture's operations may also expose critical aspects of a parent company's strategy, technology or other knowhow to partner or non-partner organizations, thereby threatening to compromise the parent's long term competitive position. Thus, problems associated with their management and performance may constitute a major impediment to the use of joint ventures.

DECIDING WHETHER TO PURSUE A JOINT VENTURE

The paradox which confronts managers is that numerous forces are pushing them toward formation of joint ventures, often with existing or potential competitors, yet these ventures often perform poorly. The frequency and extent of performance problems appear to be greater for firms with limited joint venture experience than for those which have previously been exposed to the intricacies of forming and managing these ventures. Thus, despite their potential benefits, many firms appear to have avoided the use of joint ventures or to have entered these ventures ill-prepared. As a result, they may have weakened their competitive positions or completely excluded themselves from participation within entire industries.

In deciding whether to pursue a joint venture, the potential benefits must be balanced against the costs of the venture in order to answer the following questions:

1. Should the Project be Considered at All?

You must first examine your firm's strategic objectives as well as the opportunities associated with the proposed venture and decide whether the project has a sufficiently strong economic basis to warrant additional consideration.

2. Should Our Company Attempt to Pursue the Project Alone, or with a Partner?

This requires an evaluation of the skills and resources required to successfully undertake the project, as well as your firm's competitive position vis-a-vis these requirements, in order to determine whether a solo venture would be possible and, if so, whether it would make sense strategically.

3. If with a Partner, Should It be in a Joint Venture or Through Some Other Organizational Form?

This requires an analysis of the pros and cons of both joint ventures and the alternative organizational forms available to your firm for pursuing the project, such as a wholly-owned subsidiary, licensing, subcontracting or other contractual arrangements, or some type of formal or informal, non-equity based method of cooperation with one or more other firms (e.g., joint research and development, informal agreements to collaborate, etc.)

4. Should We Only Pursue Formation of a Joint Venture, or Should We Simultaneously Consider Other Options?

The decision whether to only pursue a joint venture, or to also consider other options, will depend on such factors as the perceived relative attractiveness of a joint venture; the likelihood that a venture could be successfully established; and the time frame in which a decision must be made.

The possible outcomes of the above decision process can be listed as follows:

1. Do not pursue the project.
2. Pursue the project, but not via a joint venture.
3. Pursue the project via use of a joint venture, but simultaneously consider other options.
4. Pursue the project only via a joint venture.

The remainder of this document will be based on a firm's decision to go with one of the last two outcomes listed.

ENDNOTES

1. The data in this section are from J.M. Geringer, Trends and Traits of Canadian Joint Ventures, Ottawa: Investment Canada, forthcoming, 1989.

2. K.R. Harrigan, "Strategic Alliances and Partner Asymmetries," in F. Contractor & P. Lorange, eds., Cooperative Strategies in International Business, Lexington, Mass.: Lexington Books, 1988, pp. 205-226.

3. J.M. Geringer, Trends and Traits of Canadian Joint Ventures, Ottawa: Investment Canada, forthcoming, 1989.

CHAPTER 3

FINDING A PARTNER

Once your company has decided that a joint venture is an appropriate vehicle for pursuing its business objectives, it is time to begin the task of finding a suitable partner.(1) Selecting the "right" partner is critical since this decision influences which resources will be available to the joint venture, including its financial, human and technical capabilities. In addition, since each partner typically participates actively in the venture's major strategic decisions, and sometimes in the day-to-day activities as well, the choice of a partner has important implications for the type and extent of interactions necessary between the partners as well as the operating policies and procedures which will be put into place. The choice of a partner will influence how successfully the partners will be able to work together and, ultimately, how effectively you will be able to implement your joint venture strategy. While the "right" partner will not necessarily guarantee venture success, selection of the "wrong" partner often <u>will</u> guarantee that the joint venture will fail to achieve your strategic objectives, no matter how synergistic the business goals of the partners.

Finding and courting an appropriate partner for a joint venture can be an expensive process, and the costs are not limited to negotiating and writing the legal and operating agreements. Frequently, substantial amounts of time and other resources must also be expended in determining your firm's strategic objectives and needs, and in identifying and screening suitable prospective partners prior to initiation of formal negotiations. This is particularly imperative when your company's managers have limited experience with the proposed venture's products or markets, although costs can be significant even if you already have extensive knowledge of the joint venture's industry.

DETERMINING WHAT SELECTION CRITERIA TO EMPLOY

Each joint venture is unique in its own way and selection of a partner which will be compatible over the long term, rather than for only a short term, transitional "fling," is a complex and individualistic endeavor. Thus, the criteria which companies employ will naturally exhibit differences depending on their particular needs. Indeed, it would be futile to attempt to provide a definitive list of selection criteria which should be employed. Requirements differ and the ideal partner for one company might be a disaster for another. Nevertheless, there seem to be common elements to many joint ventures and the experiences of other managers may provide valuable guidelines for selecting partners with long term potential.

Above all, it is clear that the "right" partner will be the one which is <u>complementary</u> to your firm. The partner must be able to supply those skills and capabilities necessary in order for the venture to be economically viable and for your company to attain its strategic objectives. The partner must also be able to work effectively and efficiently with your company. The main partner selection issues for the manager are thus:

1. **What <u>IS</u> a Complementary Partner?**
2. **How Do I Go About Selecting One?**

In trying to determine what qualifies as a complementary partner, a firm must conduct its evaluation along two different dimensions of selection criteria: technical and organizational. The ideal partner for a joint venture is one which evidences complementarity on both technical and organizational dimensions. As the extent of complementarity on either of these dimensions diminishes, the likelihood that a successful joint venture will be formed decreases rapidly. The requirements for determining the appropriate criteria you should employ for evaluating the complementarity of prospective partners along these two dimensions are discussed separately in the subsections which follow.

DETERMINING SELECTION CRITERIA ASSOCIATED WITH TECHNICAL COMPLEMENTARITY

The primary selection criterion should be the potential partner's ability to provide the technical skills and resources which complement those of your firm and enable the joint venture to become economically viable. If prospective partners cannot provide these capabilities, then formation of a joint venture is a questionable proposition at best. Therefore, technical complementarity should be viewed as a minimum qualification for selecting a partner.

In determining what specific criteria you should use in selecting a partner which will be complementary with your company on a technical basis, you must answer three key questions:

1. What skills and/or resources will the joint venture need in order to be successful? In other words, what are the key success factors confronting the venture?

The first step in evaluating a partner for technical complementarity is to closely examine the proposed project with the aim of identifying and prioritizing your company's strategic needs. What are the key success factors - those few areas strongly influencing competitive position and performance - which must be satisfied in order for the joint venture to be a viable competitor?

2. Which of these critical skills and/or resources does your firm already possess, and to a sufficient extent?

After determining what skills and/or resources the joint venture must have in order to operate successfully, you must evaluate your firm's current and anticipated future competitive position vis-a-vis each of these factors. Where are the gaps, and how extensive are these gaps? For each of these gaps, is there a minimum capability level which must be achieved (for example, is there a minimum level of costs or product quality which you must attain in order to be even moderately competitive in the market), or is it a case of "more is better"?

3. Of the remaining required skills and/or resources, what is their relative priority and which could your firm most easily obtain?

After identifying your company's needs, it is necessary to determine the relative priority of the needs. Which must be overcome in order for the venture to be even moderately viable? Which of the remaining would contribute most to enhancing the competitive advantage of the joint venture as well as the attainment of your firm's strategic objectives? From these decisions, it should be possible to determine the relative priority associated with each of the needs. You should also clearly differentiate what skills and/or resources

you want from what ones you need in order for the joint venture to satisfy your objectives.

It is also necessary to determine which of the needs may be readily satisfied by other, non-joint venture means, including internal development efforts by your own firm or the use of such market mechanisms as subcontracting, licensing, and so forth. For example, the analysis should identify more than merely a financial deficiency; such resources may often be more suitably accessed via other options which will not entail the extensive managerial involvement of a joint venture partner. Although initially appealing, a joint venture based solely on a partner's financial contributions is unlikely to foster long term compatibility and thus should be avoided when possible.

The outcome of this process should be a final check on whether a joint venture is truly a suitable vehicle for pursuing the proposed project, as well as what skills and/or resources the ideal partner must have in order for the venture to be successful. For example, a European manufacturer of specialized scientific equipment wanted to expand sales of its product line in Canada and the U.S. Due to its small size and limited name recognition and experience in North America, the company was apprehensive about trying to single-handedly increase its involvement from limited exporting to a permanent, wholly-owned presence. Instead, it sought assistance from a joint venture partner. Strategic analysis of the proposed investment suggested that the ideal partner would be a recognized player in the North American scientific equipment industry with a complementary, non-overlapping product line, strong marketing and distribution capabilities, the ability to provide customer and product servicing, and the ability to invest a moderate level of financial resources. The ideal parent would also be small enough so that the European firm's product line would be a significant component of its overall activities, and would therefore receive adequate attention. Companies not satisfying these criteria would be rejected as possible co-venturers.

In addition, although financial constraints should not generally be the primary criterion for selecting a partner, many firms have commented on the importance of selecting a partner that will be able to contribute its share of financial resources in order to maintain the venture's efforts. A firm's inability to fulfill its financial commitments, due to small size, financial problems in its other operations, or existence of different discount rates and time horizons, can create turmoil for its partner. Particularly in the venture's early stages, when large negative cash flows are most common, the presence of a financial "anchor" can jeopardize an entire project. Although not always possible to identify, several symptoms may indicate potential "anchors." As suggested by the Vice-President, International of a large multinational firm, "You have to look at the partner's balance sheet and ask: 'Is it a financially solid company?' You have to look at their plans for growth and their profit orientation. Is there a difference in the strategic importance placed on the joint venture's activities? Is the partner likely to encounter financial problems in one or more divisions? If so, what will be the effect upon other activities of the partner, especially the joint venture?"

Seeking a partner with complementary technical skills and resources can permit each partner to concentrate resources in those areas where it possesses the greatest relative competence while diversifying into attractive but unfamiliar products or markets. Rather than intensifying weaknesses, joint ventures can thus be a means of creating strengths. However, many managers view dependency on other companies as undesirable and have avoided such situations whenever possible. Yet, with proper matching, each partner should

perceive a vested interest in keeping the joint venture working rather than resorting to some non-joint venture form of investment. There should be some identifiable and on-going mutual need, with each partner supplying unique capabilities or resources critical to joint venture success. By having one partner strong in areas where the other is weak, and vice versa, mutual respect is fostered and second-guessing and conflict may be mitigated.

DETERMINING SELECTION CRITERIA ASSOCIATED WITH ORGANIZATIONAL COMPLEMENTARITY

Although technical complementarity of partners is a necessary condition for forming a successful joint venture, it is generally not sufficient, particularly over the long term. Instead, the partners must also evidence complementarity on organizational dimensions. Unless the partners are able to co-operate efficiently and effectively, the joint venture is likely to encounter greatly increased levels of coordination and communication-related costs, as well as associated conflicts and compromises, and thus its performance is likely to be damaged, perhaps fatally.

In determining what criteria you should use in selecting a partner that will evidence organizational complementarity with your company, you must evaluate the firm based on the extent and the effectiveness of the partners' cooperation.

1. How <u>extensively</u> will our firms need to cooperate?

There are several considerations in evaluating the extent of cooperation which the partner firms will need to engage in. First, you must ascertain how much uncertainty the joint venture's operations are likely to confront, particularly in regard to such variables as the level of market demand, the type and methods of technology which will be employed, the supply of critical raw materials or components, the extent and type of competition which will be encountered, and the impact of government policies or other outside stakeholder groups. In general, the required extent of cooperation will increase, and at an increasing rate, as both the expected level of uncertainty and the number of dimensions of the venture's operations affected by the uncertainty increases. For example, one of our sample joint ventures was between a Canadian and a U.S. firm to produce design and engineering software for industrial markets. This venture was formed during the early stages of the product's life cycle. As a result, a high level of interaction was required between the partners due to limited knowledge of customer purchasing behavior (who, when, how much, etc.) and non-standardized and rapidly changing product specifications. In contrast, relatively high levels of market and operational certainty are associated with much lower levels of required cooperation between partners. Indeed, for the prior example, as market development proceeded through the product's life cycle and product design and market demand began to stabilize, the frequency and scope of required interactions between partners diminished rapidly.

In addition to uncertainty, the extent of required cooperation is influenced by the complexity of the activities the joint venture will engage in. Similar to the case for uncertainty, the complexity associated with operation of a joint venture tends to increase rapidly in proportion to the number of functions (such as research, design, manufacturing marketing, distribution, and so forth), products and markets it is involved in. Similarly, operation of a venture becomes a more complex task as the number or dissimilarity of the partners' strategic objectives for the venture increases. Thus, as the complexity associated with the venture's activities increases,

the importance of selecting a partner which is complementary along organizational dimensions also increases.

2. **How effectively will our firms be able to cooperate?**

The effectiveness of cooperation between partners tends to be one of, if not the, most important determinants of whether the joint venture will be able to achieve its parents' objectives over the long term. It is also much more difficult to evaluate, since it may be influenced by a large number of different factors. For example, the structural requirements of the venture - which are influenced by the required extent of cooperation discussed above - represents one influence on the required extent and importance of effective cooperation between the partners. One joint venture we examined involved design and manufacturing of a variety of customized components for use in industrial machinery and related applications. This venture required extensive interaction between the field salesforce (managed by Parent A), design and engineering (managed by Parent B) and manufacturing (managed by the joint venture's management).

The organizational compatibility of the partners is another critical determinant of the effectiveness of their cooperation. This compatibility may be associated with such variables as relative company size, extent of centralization versus decentralization, national or organizational culture, strategy and objectives, organizational structure (e.g., product versus geographic versus matrix structure), management composition and style, and so forth. For example, differences between partners in terms of management style, decision making orientation, and perspective on time - which often occur when partners differ significantly in organizational size or culture - might effectively result in corporate culture shock, frustrating management from each partner and hindering development and maintenance of good rapport between the partners. Therefore, joint ventures between companies of widely different sizes often require the creation of special environments in order to foster successful venture development. Effects of partner size differences might be reduced, for example, by giving the joint venture virtually a free hand in product development or other activities, minimizing administrative red tape and permitting quicker response time. This emphasis on autonomy is particularly appropriate for ventures which confront highly uncertain and rapidly changing environments, where slow response would be akin to a kiss of death. The willingness of a partner to allow this autonomy might also be a critical consideration in the partner selection decision.

Strategic complementarity is another critical factor influencing the effectiveness of partner cooperation. From the start, each partner must try to understand what the other participants desire from the venture. As one executive commented, "It is remarkable how many joint ventures are consummated where one or both partners do not clearly state their objectives. Under these circumstances, venture failure is almost inevitable." In attempting to determine a prospective partner's objectives, you need to examine not only the firm's current situation and goals, but also scenarios of its likely future position. Joint ventures tend to work only as long as each partner believes it is receiving benefits or is likely to benefit in the relatively near future. Because of differences in goals, what is good for one firm may be a disaster for another. For example, having different objectives in forming the venture, including the timing and level of returns on their investments, frequently produces conflicts of interest among partners. As partners' objectives diverge, there is increasing risk of dissatisfaction and associated problems. This risk may be further heightened when the joint venture's environment is characterized by a high level of uncertainty, since changes in the venture's operations are more likely under these circumstances.

Unexpected events can cause problems because of difficulty in formulating a mutually acceptable response to change. A power game can result and the venture can collapse if the partners are unable to reach agreement on an appropriate course of action.

Another consideration regarding the effectiveness of interactions between partners is the extent of similarity between the firms' operating policies and procedures. During the interviews on which this document is based, executives related several instances where differences between partners' policies caused significant problems for joint ventures. For example, one venture was nearly dissolved because inconsistencies between partners' accounting and costing systems repeatedly produced disagreements regarding timing of purchases, allocation of costs and transfer prices.

Selecting a partner whose management team - at both senior executive as well as operating levels - is compatible with your own can also facilitate effective cooperation. Personal chemistry between the principal decision makers can make or break a venture and inability of management to take to each other is frequently cited as the basis for rejecting a prospective partner or for terminating a venture. Close personal relationships, particularly among senior operating level managers, helps nurture the level of understanding necessary for a successful joint venture relationship. Managerial compatibility can enhance the partners' ability to achieve consensus on critical policy decisions and to overcome roadblocks encountered during joint venture formation and operation. Though building relationships between partners' managers may take time, it is an invaluable element of most long term joint ventures.

Yet, effective cooperation requires more than cordial relations between partners' management teams. The partner's perceived trustworthiness and commitment are also pivotal considerations, especially if the proposed joint venture involves your firm's core technologies or other proprietary capabilities which are the essence of your company's competitive advantage. Given the inherent fragility of joint ventures, today's partners could become tomorrow's competitors and a manager might understandably react with some initial distrust regarding potential partners' motives. Exposing your technological core to a partner which is unable to adequately protect this knowledge from technological theft or bleed-through can threaten your firm's competitiveness. As a result, one approach is to seek majority control, if not full ownership, of any venture and to hover over every decision the "child" might make. Another common response is to have lawyers structure the joint venture agreement to address every conceivable contingency. Yet, these responses are unlikely to promote compatibility. Instead, managers experienced in joint ventures emphasize the building of mutual understanding and trust, which can make the formal venture agreement more a symbol of a commitment to cooperate than an actual working document. Each partner needs to be comfortable that the other will honor the spirit, not just the letter, of the agreement. Without fundamental trust and commitment by each party, there is little hope for a successful working relationship.

Although it can be time-consuming and costly to conduct, it is nevertheless critical that a thorough, rather than a mere cursory and superficial analysis of the technical and organizational complementarity of prospective partners be conducted before the partner selection process proceeds and any companies are identified and contacted. The need is particularly great when your firm has limited knowledge of the joint venture's technologies, products, or target markets, or when you have had little or no prior experience working with the prospective partners. It is also true even if your firm is contacted by a prospective partner to form a joint venture and

it appears on the surface that the partners together will form a viable venture. Being overly eager is one of the worst failings of companies in pursuit of a joint venture mate. A number of executives participating in this study commented that they had been contacted by another firm and, infatuated with the prospect of quickly consummating a marriage with what appeared to be an "ideal" venture partner, they failed to exercise normal good business sense in evaluating the proposed joint venture and as a result formed a venture with the wrong partner or for the wrong project.

IDENTIFICATION AND SCREENING OF PROSPECTIVE PARTNERS

Despite the importance of selecting the "right" partner for a joint venture, managers often hesitate to devote a significant amount of corporate resources to the process of identifying and evaluating an extensive list of viable partner prospects. This is particularly the case when a partner with the minimum technical requirements appears to have been found - through an introduction at a convention or trade show, a comment from a business associate or government official or a formal expression of interest from the prospective partner itself. Often, partners appear to have been chosen for reasons not fully relevant to the organization's objectives and without a stringent comparison of alternatives. Many partners seem to have been selected almost by accident, or at least without full consideration of how they might influence the venture's operations. The need for stringent evaluation of partner prospects is particularly great if the venture is to include local partners from an unfamiliar region.

As noted earlier, the prospective partners at a minimum should be able to provide the additional capabilities which, in both the short and the longer term, are necessary to enable the venture to be competitive. This means a manager must have analyzed the venture's anticipated target market, as well as the businesses which prospective partners are currently in or likely to enter in the relatively near future, in order to identify possible synergies. However, unless a manager has a thorough knowledge of the venture's industry and the potential players, reliance on superficial scanning efforts for identifying prospective partners is unlikely to result in an optimal partner selection decision. Particularly for fast-moving technologies - such as biotechnology, robotics or computers - or for ventures in unfamiliar markets, managers should be cautious about making assumptions regarding other firms' capabilities. Reputations may be misleading, and many an executive has felt blind-sided when he belatedly discovered that a partner did not have the skills necessary for the joint venture's success.

When identifying partners, there is no single approach which will be preferable in all situations. However, the evaluation should consider such factors as the peculiar characteristics of the industry, the competitive positions of your firm and each prospective partner, and the venture's anticipated requirements for capital and other resources. In many cases, prospects can be identified from your firm's own contacts, although the use of consultants, industry associations, financial or accounting firms, government agencies - even industry directories or the Yellow Pages - may also provide valuable leads. The decision whether to use consultants or other outside agents for this task is typically a function of your firm's knowledge of the proposed venture's market, technology, competitors, etc.; the type and extent of skill and resource gaps which confront your firm; the type and extent of interactions which are likely to be required with the partner; and the amount of search time and expense which your firm's managers can realistically afford to engage in.

Generally, among the first potential partners to be considered are the distributors, suppliers and customers for the industry of the proposed venture, particularly firms with which your company has had satisfactory prior relationships. A partner you have previously done business with may be attractive since you have evidence of how well the companies can work together, personal ties already exist between your organizations, and you generally have a better understanding of the skills, resources, culture and ethics of the partner. Yet, despite prior relationships, these firms may not represent the best partner choice for a particular joint venture. They may lack the necessary skills or resources, the venture may not fit within their strategic plan, or they may even be preempted from participation due to prior agreements with other firms.

Of course, extensive search and screening efforts are not always feasible. Sometimes, the nature of the proposed investment dictates a limited range of prospective partners. For instance, there might be only one firm with access to the technology or raw materials needed by the joint venture. In other cases, government regulations regarding foreign ownership or anti-competitive statutes may sharply limit the number of available partner prospects. However, even if only one or a few viable partner prospects exist, screening these companies for suitability as joint venture colleagues is still a critical task. In addition, unless the partner is likely to be compatible, you might instead wish to pursue other, non-joint venture alternatives, such as licensing, contractual relationships (e.g., long term supply contracts) or even full equity ownership via a merger, acquisition or new start-up. Conflicts between partners are best avoided if anticipated before the venture is established, and extreme care should be taken in selecting the other party or parties. The additional effort expended up front in selecting the "right" partner may repay itself many times over in avoided costs of misunderstandings, delays and divorce.

When identifying suitable partner prospects, it is essential that the partner offers strong prospects for developing an effective long term working relationship. Partners have a tendency to crystallize into personalities, of which some types may not be conducive to the venture's long term viability. Although satisfying the joint venture's technical requirements is a necessary element of the partner selection decision, it is generally not sufficient. It should also be apparent that the partners, linked together, will form a complete business both in terms of technical capabilities and their ability to interact successfully.

Because of the presumed long term nature of most joint ventures and the costs associated with premature dissolution, there tend to be relatively high financial and human costs associated with selection of partners for successful ventures. Firms must be willing to incur substantial search costs, including those associated with developing selection criteria and evaluating partners, as well as the extensive resource expenditures typically involved in the negotiation stage. In addition, the process needs to be approached with considerable patience and realistic expectations. Indeed, many managers insist on a long courtship period with a prospective partner before committing themselves to forming a joint venture. A company unwilling to accept these preconditions should probably consider other investment options, rather than trying to minimize resource expenditures by cutting corners on the quantity and quality of effort expended on the partner selection and evaluation process.

ENDNOTES

1. Portions of this chapter are based on J. M. Geringer, "Selection of Partners for International Joint Ventures," Business Quarterly, Autumn, 1988, pp. 31-36, and on J. M. Geringer, Joint Venture Partner Selection: Strategies for Developed Countries, Westport, Connecticut: Quorum Books, a division of Greenwood Press, 1988.

CHAPTER 4

NEGOTIATING THE JOINT VENTURE AGREEMENT

Once your firm has completed the identification and evaluation of prospective partners and has decided to pursue a venture with one or more of these companies, then you are ready to begin negotiations toward a mutually acceptable joint venture agreement. As with partner selection, there is no single "best" way to pursue negotiations. The length of time required to negotiate an agreement, the number of steps involved and the manner in which the negotiations are conducted will depend on such factors as the companies and individuals involved, the strategic importance of the venture to the participants, the nature of prior relationships between the partners, the complexity of the proposed agreement, the amount of up-front research and planning which has been done, and the time, money and personnel available for negotiations. Indeed, the amount of time required to negotiate these alliances can range from 100 to 5,000 or more hours.(1) However, based on the experiences of the executives participating in this study, we were able to identify a set of basic guidelines regarding how the negotiations should be pursued. This chapter discusses these guidelines in the following order: prenegotiation activities, negotiation of the agreement, and conclusion of negotiations.(2)

PRENEGOTIATION ACTIVITIES

Determining the Negotiating Objectives, Issues and Strategy

As with any other proposal involving a major commitment of management time and other corporate resources, companies considering formation of a joint venture should first prepare a business plan for the proposed venture. Nevertheless, many of the parent firms we surveyed had failed to conduct adequate preventure planning for their ventures, often leading to performance problems later. Prior to beginning negotiations, it is often advisable to thoroughly review your firm's strategic objectives for the joint venture, as well as those of your prospective partner. What are the dominant motives driving each of the firms to consider entering into a joint venture? What does each <u>want</u> to achieve from the venture, and what does each <u>need</u> to achieve from it? What are each party's main strengths and weaknesses? What, if any, market advantages will the joint venture's products or services have relative to the competition? Does a viable market opportunity truly exist, and will the parents be able to supply the necessary resources to successfully exploit it? How will the joint venture fit with the other operations of each partner, and what are the implications regarding how each party will want to structure and manage the venture? In order to adequately answer these types of questions, you must conduct a thorough and often tedious analysis of the proposed venture's competitive environment as well as the partner companies' operations.

It is often advisable to involve the key people who will be working with or impacted by the joint venture - especially senior executives, technical specialists, staff and line managers - in these prenegotiation analyses. Many of them should already be familiar with the key issues associated with the

prospective partner and the deal, due to involvement in the evaluation of both the joint venture proposal and the list of partner prospects. Their presence can improve the quality of the analysis by raising strategic and operational concerns - about your firm, the prospective partner, competitors, customers, and suppliers - which will be critical to the later functioning of the venture. By raising these issues prior to negotiations, it will facilitate your firm's ability to identify and prioritize the main issues which are likely to arise during the negotiations, the positions and desired outcomes of the participants vis-a-vis these issues, and how flexible the parties are likely to be on each issue. It can also serve as an additional check on the desirability of forming a joint venture, and with this particular partner, in order to achieve your strategic objectives. In addition, participation of these key players can help you identify which people would be most suitable to serve as members of the negotiating team, as support personnel to the negotiators, or as employees of the joint venture itself. By incorporating the individuals most affected by the joint venture within the negotiation process, you may also be able to increase their sense of ownership of, and commitment to, the agreement which ultimately results. Furthermore, this process can assist you in identifying which individuals are not fully committed to the joint venture idea and who might thus try to either kill the deal or sabotage the venture once it has been formed.

Conducting this type of thorough analysis prior to initiation of the formal negotiations can significantly improve your firm's ability to map out a successful strategy for the negotiations. By addressing potential problems at the outset, the analysis provides the foundation for an effective negotiation effort - one which is likely to produce an agreement which will achieve the objectives of both your firm and your partner.

Selecting the Negotiating Team

Providing the necessary mix of skills and personalities. The individuals which comprise your negotiating team represent one of the most important influences on your firm's ability to create a successful agreement and a workable joint venture. The negotiators must be able to work together effectively in pursuing the best interests of your firm, to identify the partner's objectives and position on key issues, to communicate your company's expectations for the venture, to propose how the venture will be structured and managed, to accurately evaluate the contributions of each partner organization, and to resolve disagreements which are likely to arise during negotiations. They must be able to perform these tasks despite differences between them and the prospective partner in terms of strategic objectives, language, or national or corporate culture. These negotiating skills are particulary critical in those circumstances where the parents have had little or no prior experience working with either joint ventures or the prospective partner.

Cultural differences can stymie negotiations by hindering the development of rapport and understanding between partners. The importance of a partner with adequate English (or French) language capability, or the Canadian firm's facility with the language of the partner, should not be overlooked. Because of cultural or language differences, subtle nuances might be more difficult to communicate. As a result, negotiators may have to substitute simple, "Dick-and-Jane" terminology for more specific technical jargon, leading to greater expenditures of time in negotiations. Thus, the simple ability to communicate with one's counterpart from a partner firm often makes a significant difference in the prospects for negotiating a successful joint

venture agreement, and the absence of this ability has caused more than a few disasters.

In general, the negotiating team must collectively encompass the full range of technical, organizational and personal skills which are relevant for the proposed joint venture. Thus, when possible, the team's membership should include personnel with the requisite functional expertise - be it in research, production, marketing, technology or other areas - as well as in-depth knowledge of the specific products and/or markets which the joint venture will be involved with. The team should also include one or more operating level personnel who will be interacting extensively with the venture and/or who will be managing the venture itself. Furthermore, it is important for the negotiating team to include individuals who have both the general management perspective as well as the hierarchical power necessary to "see the big picture," to make key decisions and to build support for the venture within the parent firm. In particular, it is critical to examine the role of joint venture champions and of top management in the negotiating team.

The critical role of joint venture champions. In evaluating partners and negotiating the joint venture agreement, there are people from each company who play a particularly critical role in the process. Examination of prior ventures reveals that there are usually one to three key individuals, or venture champions, who are critical to the partner selection decision and to efforts to successfully implement a joint venture agreement. Typically, these individuals become involved very early in the process of considering formation of a joint venture, and they occupy line rather than staff positions in the upper-middle to upper levels of the firms' management hierarchies.

The joint venture champions serve as catalysts for the process of identifying, evaluating and negotiating with prospective partners. Indeed, when they have the requisite negotiating skills, they often serve as the chief negotiators for their firms. Because they function as the driving force for the venture's formation, their continued involvement in the process is essential. For this reason, the existence of more than one champion in each partner company typically enhanced prospects for successful venture formation. When companies had only one champion, loss of that individual - due to transfer, turnover or other cause - frequently resulted either in termination of formation efforts or significant delays in the negotiation process while relationships were established with a new champion. In contrast, when more than one champion existed, loss of one of them may have created problems, but the process of forming and operating the venture was generally able to proceed with only minor delays.

Because of their central role in the formation process and the breadth of activities which must be addressed, certain types of managers seemed to be most effective as joint venture champions. In general, successful champions evidenced entrepreneurial skills and were characterized by broader and more generalized managerial training, rather than embodying more narrow technical specialties such as law, finance or other support functions. To ensure that it will be economically viable, champions must be able to understand and integrate the broader strategic issues regarding the proposed joint venture's activities. Functional myopia associated with a narrowly trained manager might result in these critical issues either not being raised or being insufficiently addressed, and thereby threaten venture performance. Yet, in addition to their general management orientation, at least one champion from each company should also evidence fluency with the critical functional activities of the venture, such as R&D, manufacturing or marketing. To further enhance decision making efforts and to adequately communicate organizational commitment to prospective partners, it is critical that

champions evidence a level of hierarchical responsibility commensurate with the purported strategic importance of the venture. If the champion lacks sufficient hierarchical power, an organization may inadvertently send the message to its employees that the venture lacks top management support, virtually ensuring that employees will not fully commit themselves and thereby harming prospects for venture success.

When venture champions embody the above traits, their ability to evaluate and negotiate with prospective partners is significantly enhanced. Despite this caveat, a surprising number of firms delegate responsibility for partner selection and negotiation to junior level line managers or to staff members, especially lawyers, who may be ill-equipped to function as full-fledged champions. Therefore, one of the objectives of the prenegotiation stage is to identify the individual(s) who would be most suitable to function in the critical role of joint venture champion.

The Role of Top Management. Especially for larger joint ventures and those accorded high strategic importance, top management of the company generally have some degree of direct participation in the negotiation process. These very senior level executives frequently do not assume an active role as one of the formal champions of the venture. Nevertheless, top managers' participation is pivotal in successful negotiation efforts, due to their ability to communicate the extent of a company's commitment to prospective partners and to employees within their own firm. They also tend to be critical to successful negotiation of the initial memorandum of understanding (MOU), which serves as the foundation for the formal legal agreement which is subsequently drawn up between the partners. In addition, top management involvement can help prevent or overcome negotiating deadlocks which may occur between the partners' operating level or legal personnel. Their participation also confers legitimacy to the proposed venture, helping develop and sustain the critical level of commitment necessary to successfully complete negotiations and establish a positive foundation for venture operation.

Despite the importance of having top management involved in some capacity in the joint venture negotiations, it may be advisable to limit the extent of such involvement. As noted in Chapter 3, amicable relations between partners' top management is often a critical consideration in selecting a partner. However, if they are too concerned with preserving this congeniality, partners' CEOs may avoid addressing issues which they have limited knowledge of or on which potential conflicts could arise, preferring to let these issues be resolved later by the negotiators or the venture managers. This type of behavior can have dangerous ramifications, since it can result in a MOU which is inappropriate for the long term interests of one or both partners, and thus sow the seeds for future discontent. Therefore, the negotiating team should generally not be restricted to senior managers, in order to ensure that the negotiations will address difficult issues which may lie outside the technical or organizational realm of top management.

Final Preparation of the Negotiating Team

It is often worthwhile for the negotiating team to meet together one or more times prior to initiating negotiations. These meetings can facilitate the members' ability to recognize each other's capabilities as sources of expert information, as strategists and as negotiators. The meetings also provide an opportunity for the members to discuss the team's goals, strategy and tactics; to identify what points need to be addressed and how flexible of a position they should take on each; to determine what information to divulge and when; to identify each member's appropriate role in the negotiation process; and to set realistic objectives. This can help during the ensuing

negotiations by reducing the likelihood of confusion or of sending inappropriate or mixed messages to the partner, as well as the chance that the team will become consumed by the urge to "complete a deal," regardless of its ultimate form. This latter concern is particularly crucial in those cases where the negotiation team has been given the authority to wield decision making power over some or all of the critical aspects of the joint venture agreement.

It may also be worthwhile noting several common mistakes associated with negotiating joint venture agreements. The biggest mistake is failing to do your homework prior to negotiations, including a thorough analysis of the venture's technology, products or services, and markets, as well as of your firm and your prospective partner. In addition, inexperienced negotiators often avoid presenting any proposal or negotiating points which they think a prospective partner may object to, thus potentially limiting their firm's payoffs from the venture. Similarly, inexperienced or timid negotiators often avoid asking difficult but necessary questions regarding the venture's or the partner's operations. Finally, negotiators eager to complete an agreement often back off from a fair and equitable negotiating position in an effort to preserve harmony with the partner, but only succeed in setting the stage for later conflicts. Instead, it is generally best to pursue a long courtship and move slowly toward consensus on the venture's objectives and means, in order to ensure that the final agreement is well-designed and equitable and thus able to provide the foundation for a successful venture.

NEGOTIATION OF THE AGREEMENT

Determining Objectives

After the partners' negotiating teams are introduced and have a chance to become comfortable with each other, the first task is to achieve agreement regarding the proposed venture's objectives. This process will help ensure that each party is on the same general wavelength in terms of what they want the venture to become. Although initial discussions may tend to be general, the key to successful joint venture performance appears to be the partners' ability to agree upon a well-defined and focused scope and objectives for the venture, and the basic structural and operational requirements necessary to achieve these objectives. Designing the scope and purpose provision often proves to be more demanding than anticipated, but the attempt alone may help expose unsuspected differences in perspectives and help to avoid later disagreements. In many cases, this initial stage of negotiations has involved only the CEOs or other senior managers of the prospective partners, rather than the entire negotiating team. However, the use of this approach must be managed carefully in order to avoid the potential pitfalls which were discussed above.

Memorandum of Understanding

Once the partners have agreed on a well-defined, focused set of venture objectives, and the basics for achieving them, it is common for the firms to engage in preparation of a memorandum of understanding, or MOU, as well as to begin exchanges of proposed contract language. Varying in length and detail from a paragraph or two to a dozen or more pages, MOUs are intended as a starting point for the more detailed formal negotiations and legal venture agreement which will follow. By forcing the prospective partners to determine up-front what each firm wants and needs from the venture, the negotiators are better able to evaluate early in the process whether the proposed venture is really feasible. The MOU also sets down a framework to help focus the negotiating teams' efforts regarding what issues to address and how. MOUs can

be used to perpetuate confidentiality agreements and preclude either company from entering into simultaneous negotiations with other firms, as well as setting a timetable for completing negotiations. In addition, MOUs provide a basis against which the final legal agreement can be compared, thus ensuring that the outcome of technical and legal discussions does not obfuscate the original intentions of the negotiators. Furthermore, since no joint venture agreement can effectively anticipate all possible contingencies, the MOU often serves as a dispute resolution mechanism after venture startup by enabling the partners to go beyond the legal technicalities of the agreement in determining the appropriate means of resolving uncertainties which might confront the venture's operations.

Although they are an integral part of most joint venture negotiations, MOUs also have potential drawbacks. The major concern with these preliminary agreements is that, although not legally binding, they can psychologically lock the parties into an agreement which may not be suitable for one or more of the partners. Once agreement on the MOU has been reached, and particularly if this act has been heralded in the press, the level of commitment to this agreement tends to escalate rapidly, often to the point where the partners feel they cannot withdraw from or transform the direction of the negotiations. Particularly if it was negotiated between the CEOs and if not all of the critical issues were adequately addressed, the MOU can set the foundation for a bad marriage between the corporate partners. Complications may arise that call into question the validity of the venture, yet the negotiators may not feel that they can retreat from the initial agreement without losing face. For these reasons, it is desirable that the parties not agree to a MOU too early, before the full ramifications of the agreement have been considered by the individuals with the required technical and organizational capabilities.

Components of a Joint Venture Agreement

Allocation of ownership and control. Allocation of ownership and control over individual activities of the joint venture is a critical determinant of venture performance, and is a predominant issue in forming and operating most ventures. For example, the contributor of key technologies or other resources to the venture is likely to have a strong interest in supervising its use and further development. Due to the importance of this topic, we have devoted an entire chapter, Chapter 5, to discussing key issues associated with venture ownership and control.

Valuation of Partner Contributions. In addition to control, one of the first issues to consider is the resource requirements of the venture and valuation of the partners' contributions. Initial capital, including both cash and non-cash assets, must be contributed to the venture in order to complete its organization. The necessity of valuing these contributions, particularly non-cash considerations, is dictated by both corporate law and tax considerations. Yet, the valuation of partners' contributions to the venture is often one of the most difficult issues for the negotiators to address. These contributions can include both tangible assets such as facilities, equipment, personnel or financial resources, as well as intangible assets such as name brands, copyrights, or technological knowhow. Achieving consensus regarding how to place values on these contributions tends to be difficult and time consuming due to differences between partners regarding how they determine the relative value, life and depreciation schedules of the various assets which are being contributed to the venture. Nevertheless, a top priority for negotiators is to conduct a quantitative and qualitative evaluation of the partners' asset contributions to the venture, including

essential soft inputs such as corporate or brand names or reputation; improved access to preferable financing rates, distribution channels, or government contracts or regulatory approvals; or managerial expertise in starting or managing the business. Conducting an effective evaluation of both the hard and soft contributions is critical because the value of each firm's inputs influences how the venture will ultimately be structured and managed. In addition, determining how these contributions will be accounted for by the venture and its parents can influence how assets and liabilities appear on the entities' books, as well as what the tax position and payout structure will be.

Contributions of intellectual property, including copyrights, trademarks, patented and unpatented technology and other knowhow represent some of the most important yet challenging assets for the negotiators to place values on. In addition, the method used to price intellectual property may have important implications for the tax consequences of transferring these assets, particularly for ventures involving foreign partners. For example, the choice between license and direct sale of intangibles to the venture can influence such things as whether the contributions appear on an entity's books as assets, the tax status of the contributions, and thus what tax rules will be applicable to the parents and to the venture itself. Similar concerns may arise regarding hard assets, such as plant or equipment contributions. Furthermore, these decisions can have important implications on the level and timing of returns to the parents, particularly given the current environment of exchange rate volatility which can transform a well-conceived royalty agreement into a financial disaster for the venture or parents. Indeed, particularly for ventures with foreign partners, it is often worthwhile to incorporate specific mechanisms into the joint venture agreement for addressing currency fluctuations.

During negotiations, the parents should also establish a set of plans and procedures for future venture funding. Initial contributions and available institutional financing may be able to satisfy the venture's anticipated requirements. Nevertheless, the possibility always exists that additional equity contributions may also be required, and the ratio in which the parents will participate in future funding is a matter of negotiation. The joint venture agreement should clearly specify the level, mix (debt/equity ratio), sources (debt, equity, government incentives, etc), timing and circumstances for contributing additional financial or nonfinancial resources to the venture. In addition, it is necessary to address the consequences if one party fails to make a contribution when required. The existence of partners with meager financial resources or relatively diminished access to inexpensive capital sources need not prevent joint venture formation or yield premature buyout or termination, especially when insufficient financial contributions are not due solely to financial insolvency. For example, the venture agreement may include penalties if either partner attempts to sidestep its financial obligations. This often occurs if a partner encounters problems in its other business activities; if dramatic changes in the availability, liquidity or exchange rate of currencies significantly alters the real level of contributions; or if the partners place different priorities on exposure management. Means of addressing defaults in financial contributions include the use of clauses dictating that shareholdings or payouts be contingent upon each partner's contributions. A more extreme penalty might include a requirement that the defaulting party reduce or forfeit its interest in the venture, or to sell its shareholdings to its partner at a predetermined bargain price.

Government Incentive Programs. Finally, in negotiating for the contributions of assets necessary for the venture to be viable, the partners should not disregard the potential for accessing government incentives. Various forms of incentives, from federal, provincial and local levels of government, may be available to the venture for such things as training, locational assistance, provision of land or site improvements, credits for investing in research or facilities, and tax holidays or abatements. Although these incentives may help stretch the resources of the parent firms and may significantly influence the potential risks and payoffs of a joint venture, participation in government incentive programs may also have drawbacks. For example, these programs may require specified levels of employment, investment, local content or exports, as well as requiring government approval before making major reallocations or changes to the venture's activities. As a result, it is critical that the partners seek the assistance of qualified experts in evaluating the desirability of seeking government incentives for their venture.

Service Contracts. Another important aspect of joint venture negotiations is the determination of what, if any, service contracts the joint venture will enter into with the parent companies. The existence of these contracts can mean added responsibilities and returns for the parent. Common forms of service contracts include management; supply; sales; purchasing; technology licensing, transfer or support; information systems; accounting and financial services; and legal, public relations or other administrative services. In addition to determining what service contracts will be used, it is also necessary to specify what will and will not be included in these contracts, as well as the conditions under which the agreements will operate. For example, a technology licensing agreement should specify whether the agreement applies only to basic transfer of the technology (e.g., giving the venture an operating manual) or whether it also includes engineering and troubleshooting support. The agreement also should specify the length of time the agreement is valid, and whether it applies to a one-time transfer of technology (such as a turn-key operation), or includes technological developments on a continuing basis.

Although the use of service contracts can reduce the costs and time required for the venture's start-up by allowing it to leverage the parent firm's infrastructural resource base, these contracts may also have drawbacks. The use of these contracts raises the issue of whether, and to what extent, the supplier of the services is allowed to take money out of the venture other than by way of dividends. The provider of the services may argue that its equity position in the joint venture should be treated distinctly from its service contract, and that the latter should include the same royalty or fee as would be charged to unrelated parties. Nevertheless, these contracts can create substantial imbalance in relative payouts to the partner companies, and may still fail to produce the desired outcomes. For example, it often requires a considerable amount of parent and joint venture management time to make the agreements work as intended, and unless the proper cooperative environment is established they may not work at all. In addition, since they involve a parent firm rather than an arm's length, external party, it may be more difficult to terminate or renegotiate these agreements. This may be particularly troublesome if the parent tries to manage the agreement from the perspective of its own well-being, rather than that of the joint venture.

Determining payouts from the venture to the parents. Dividends were a relatively low priority for many of our sample firms, particularly during the ventures' early years. Several of the ventures had not declared any

distributions, although profits often were accrued directly by the parent firms via transfer prices and service contracts. Nevertheless, it should not be forgotten that a central objective of most joint ventures is to generate profits over the long term, and that differences may arise regarding the appropriate means of distributing these earnings. Disagreements commonly arise regarding retention of earnings for reinvestment and sustained growth versus distribution to the parent firms. Although this issue may be left to the discretion of the venture's board of directors, it is often worthwhile to address it explicitly within the joint venture agreement. For example, one means of avoiding or overcoming parent disagreements on distribution policies is to include a provision that a preset percentage, possibly zero, of earnings will be distributed if the partners are unable to resolve the issue on their own.

Determining the Venture's Policies and Procedures. It is common for partners from different business and national cultures to disagree on the basic substance of operating policies and procedures. For example, what accounting practices, budgeting and financial reporting procedures, health and safety guidelines, and environmental protection procedures should the joint venture adopt? What personnel practices will be utilized by the venture? How will raw materials or components be sourced and, if some or all of them will be purchased from a partner, how will transfer prices be determined? How will profitability of the venture be determined, and what will be the guidelines regarding reinvestment versus dividends? If some or all of the venture's products or services will be exported to other regions or nations, how will control over these activities be determined? If disagreements between the partners or with the joint venture managers arise, what mechanisms will be used to resolve conflicts? Will key decisions require consensus or a mere majority, and will a tie-breaker be utilized in case of a decision making deadlock? For example, determination of transfer prices for inputs or outputs of the venture was one of the most common points of contention in our sample joint ventures. If one partner provides raw materials to the joint venture, it is receiving additional revenues from its role as a supplier. Its partner may begin to resent the fact that there is an apparent disparity in the level of returns the parents are receiving from the venture. Partners may complain that the transfer prices are too high or too low, yet there may not be a suitable market rate to use for comparison. As a result of these concerns, partner resentment and mistrust may begin to build, threatening the venture's survival.

The need to anticipate and resolve these basic issues further exacerbates the complexity associated with negotiation of a joint venture agreement. Nevertheless, it was clear from our interviews that the negotiators should include specific provisions regarding what the policies and procedures for these activities should be, as well as designating who will be responsible for controlling each of the activities. Partners should also clearly communicate the types of policies they will be comfortable working with. For example, firms from Canada, the U.S. and Europe are typically accustomed to operating with lower debt-to-equity ratios than is the case in Japan. Differences in operating approaches often result from cultural biases and negotiators, not conscious of the existence of these biases, may take for granted that there is a "right" way to do things. As a result, problems between the partners will be more likely to occur after the venture is formed. Therefore, the venture's operating policies and procedures should be addressed thoroughly during venture negotiations.

Management of human resources. Failure to adequately plan for human resources can doom an alliance before it even begins operations. Yet, a recent Coopers & Lybrand study found that only about 4 percent of the time spent creating joint ventures was devoted to human resource issues. A number of the executives participating in this study commented that, had they devoted the additional time and energy which these issues warranted, their ventures would have stood a much greater chance of success. It is critical that the negotiations address such human resource issues as: What will be the composition of the venture's board of directors? How and from where (from which parent, or from outside) will the venture's managers be recruited, particularly for key positions such as the venture's general manager, chief financial officer, technical directors, and other functional department heads? Will these positions be rotated between parents and over what time frames, such as yearly, every 3 years, etc.? What will their responsibilities be? To whom will they report, and how frequently? What committees, such as executive policy committees or management committees, will be formed and how will their membership be decided? What policies will be instituted regarding career paths, performance evaluations, benefits, and so forth - particularly for employees recruited from a parent firm?

It is crucial that the prospective partners carefully consider how they wish the joint venture to be operated and respond to each of these issues in order to avoid later surprises and conflicts. More discussion on the specifics of selection, training, performance evaluation and compensation strategies for the joint venture is contained in Chapter 6.

Legal Issues. The formal joint venture agreement is inevitably prepared by the partners' legal staff, and it is essential that these people are competent with the specific legal issues of concern to joint ventures. Certain rights of the parties, such as transferability of shares, provisions for deadlocks, and minority protections, are included in all or virtually all agreements. However, the specific legal topics which must be addressed in these agreements may vary enormously, depending on the unique circumstances of your venture. Therefore, we will not endeavor to address them in this document, but instead refer you to qualified experts.

However, several legal requirements do warrant brief mention in this document. In particular, because of the potential effect that joint ventures may have on the parent firms' competitive positions, it is often necessary to include legal protections in the final agreement. For example, agreements may include minority protection clauses or veto rights to limit the joint venture board's ability to act on key decisions without the consent of a minority partner. These decisions commonly include major capital expenditures, asset disposal, major changes in the nature of a venture's business activities, appointment or dismissal of key employees, or changes in shareholdings. These types of clauses can effectively neutralize potential adverse effects of asymmetries in venture ownership, and thereby minimize damage to the minority firm's competitive position.

Other common legal protections include such devices as non-competition clauses, technology non-disclosure, and patent or copyright coverage. Despite the presence of such clauses in the agreement, however, you must remember that there are practical limits on the ability of any legal document to protect knowhow or knowwho which is critical to the maintenance of your firm's competitive edge. Therefore, it is essential that the negotiators consider the inclusion of additional structural or operational measures to guard against undesired leakages of any readily compromised technology, knowhow or other proprietary resources.

Another legal issue is that all cooperative ventures raise potential concerns regarding anti-competitive effects and, particularly for the larger ventures, they may be subject to federal review. However, there appears to be a trend toward an easing of concern regarding the anti-competitive implications of most ventures, as well as a recognition that, in an increasingly globalized competitive marketplace, many of these ventures may actually foster increased levels of competition as well as permitting the survival of domestic firms. Therefore, in contrast to the 1970s and early 1980s, the threat of unfavorable anti-competitive reviews should not constitute a major barrier to the formation of most joint ventures.

Exit or Termination Clauses. In addition to a pre-set, usually renewable time limit on the agreement, virtually every executive which we interviewed advocated the use of termination clauses in the joint venture agreements. These clauses provide each partner with a graceful way of ending the joint venture relationship in case of a change in their objectives, unsatisfactory performance of the venture, problems working with the partner, or other reasons. Termination clauses typically give the other partner either the right of first refusal or else provide for put-sell or "shotgun" means of terminating the venture. In other words, if Partner A wants to end the venture, it sets a price for its shares and Partner B has to either buy A out at the set price or sell its own shares to A at that price. These types of clauses tend to work best if the parties are relatively equal in their financial capability, legal status and proportionate interests in the venture. As noted by one manufacturing executive, "Shotgun clauses provide 'encouragement' for partners to set a reasonable price for their portion of the business, or else they end up paying for their greediness." However, if significant inequality exists between the partners, the weaker parent may find itself at a severe disadvantage. For example, if one firm has limited financial capacity, the bidding partner may take advantage of the situation by proposing a price that, although unreasonably low, nevertheless cannot be matched by the weaker firm. To an extent, it may be possible to overcome this problem by leaving valuation of the venture to an independent, outside party.

When explicit termination clauses are not feasible, due to partner resistance, it may be possible to substitute implicit termination provisions. For example, it may be possible to establish target sales or profit levels. If the venture fails to achieve these levels within a specific time period, then the partners would be required to renegotiate the joint venture agreement.

Although termination clauses are prevalent, they can also severely harm a partner's operations, particularly when the firm is dependent on continuation of the joint venture's activities. Therefore, many joint venture agreements include provisions that provide the partners with a vested interest in keeping the joint venture working. One method is to establish a means of "exchanging hostages." For example, the venture agreement might stipulate that a unilateral decision to break up the corporate marriage prematurely would result in a substantial charge - "alimony" payments if you will - as well as covenants against engaging in competing activities within a specified time period or in a particular market area. The agreement might also guarantee cross purchases of specified volumes of products or services by the partners. This option can reduce the impact of a break-up upon a more-dependent firm by guaranteeing access to critical raw materials or sales revenues during the painful readjustment period.

Avoiding a Zero-Sum Game Mentality

Because of the presumed long term nature of the relationship and the need for fostering mutual trust and commitment, managers should refrain from a tendency to approach negotiations as a zero-sum game. Attempting to "beat the partner" in the negotiation stage will generally prove dysfunctional in the long run. As stated by the president of an electronic equipment firm, "In a successful negotiation, everyone wins. Everyone! As soon as one of the parties feels they have lost, they will work very hard to change things. No one likes to be a loser. The antagonisms grow to the point where they destroy reasonableness. Approaching joint venture negotiations as a game which will have a winner and a loser is a tragic approach." This perspective was reinforced by a food industry executive who stated, "The content of any proposed agreement should be reasonable for all parties. If you believe it's reasonable, don't hesitate to lobby strongly for it. However, it's useless to pursue an unreasonable agreement. Even if you are able to convince the partner to initially agree to it, he'll eventually feel cheated and the agreement will ultimately fail."

For some, the idea of cooperating with a partner appears to stand in direct opposition to a corporate value system holding self-sufficiency and aggressive competition as central ideals. Yet, regardless of the size or type of business, a joint venture must be founded and operated in the spirit of compromise and cooperation. A parent unwilling to recognize this principle should consider pursuing other, non-joint venture options or it is likely to find itself confronting constant difficulties. An inequitable agreement, unless remedied, can result in deadlocks or dissolution, causing the partners to suffer foregone opportunities, lost capital and other resources, and compromised proprietary information, as well as an enormous amount of stress and emotional anguish.

COMPLETION OF NEGOTIATIONS

Final Review Before Signing

When the negotiations are nearing completion, it is important for your firm and its negotiating team to conduct a final evaluation of the agreement prior to its formal signing. Is the overall agreement fair and equitable, and are your contributions fairly evaluated? Are your firm's objectives likely to be satisfied by this agreement? Is the joint venture likely to be successful given the structural and operational prescriptions which have been outlined? Is the proposed venture likely to survive adverse or changing competitive conditions? Do you still want to work with the partner company? It is critical to examine these issues and, depending on your responses to these questions, be willing to force a renegotiation or severance of the agreement. Despite any potential embarrassment from leaving your potential venture mate at the joint venture alter, avoiding a problem marriage at this stage is likely to be much less costly and painful than trying to obtain a divorce later.

If you <u>do</u> go ahead with the venture, be sure that the agreement is tightly focused and well-defined, so that the interests of each partner will be protected. The best way to reduce joint venture problems is to try to anticipate and prepare for all of the major contingencies at the start. Many of the problems which confronted our sample joint ventures involved agreements which did not clearly delineate the venture's objectives and scope of operations, what policies and procedures would govern the operations, or how responsibility for the venture was to be allocated between the partners.

Despite the potential advantages of a thorough venture agreement, also keep in mind that the formal agreement should only represent a framework for

guiding the venture's activities and that the day-to-day management of the venture will not be governed in a legalistic manner. As noted by one CEO, partners generally, "don't start looking at the specifics of the venture agreement until the relationship starts breaking down and you're contemplating getting out." Furthermore, regardless of protections written into the joint venture agreement, no legal document is fail-safe. Therefore, each partner needs to be comfortable that the other will honor the spirit, not just the letter, of the agreement. A joint venture relationship is delicate at best and complicated at worst. Without fundamental trust and commitment by each party, there is little hope for a successful working relationship.

The On-Going Nature of Joint Venture Negotiations

Managers should recognize that joint ventures are usually characterized by on-going negotiations, even after the formal agreement is signed and the venture is formally established. It is inevitable that unanticipated changes in the internal and external environment will occur. Under such circumstances, strict reliance on the initially negotiated contract may produce less than satisfactory performance for one or both of the partners, thus threatening the venture's long term viability unless modifications are implemented. While not all aspects of a joint venture agreement may be subject to renegotiation, the principal impetus for re-opening discussions on some or all parts of the joint venture agreement is concern over potential inequities or domination. This is particularly the case if there is also substantial disparity in the relative sizes of the partners. Since a balanced agreement is essential to the maintenance of trust, circumstances which produce perceived imbalances typically result in partner outcry and pressure for modifications to the agreement. To the extent that partners perceive incompatibilities between themselves and their venture mates and an inability to rectify the situation, what begins as a relatively minor annoyance may mushroom into a significant and possibly fatal source of friction.

One means of minimizing problems within a joint venture is to maintain continuity among the venture's key personnel. Because of their on-going relationship with their peers in the partner organization, these individuals are a critical element in the maintenance of mutual trust. Personnel changes, especially among the venture's champions, can threaten the personal chemistry which has been built up between partners and necessitate further negotiations to re-establish this human balance. Although several firms consciously exploited this tendency as a means of re-opening negotiations, be forewarned that such a strategy may also entail significant risks.

ENDNOTES

1. Coopers & Lybrand/Yankelovich, Skelly & White, Inc., "Collaborative Ventures: A Pragmatic Approach to Business Expansion in the Eighties," 1986.

2. Portions of this chapter have been adapted from J. M. Geringer, "Selection of Partners for International Joint Ventures," Business Quarterly, Autumn, 1988, pp. 31-36, and from J. M. Geringer, Joint Venture Partner Selection: Strategies for Developed Countries, Westport, Connecticut: Quorum Books, a division of Greenwood Press, 1988.

CHAPTER 5

OWNERSHIP AND CONTROL OF THE VENTURE

Since more firms are becoming involved in joint ventures in their core markets or products, and since these ventures have often performed poorly, a critical issue is how should these ventures be managed in order to promote successful performance and the attainment of strategic objectives?(1) Clearly, successful management and control of joint ventures represents a major challenge to all of the parties involved in the venture. Since each joint venture is unique in its own way, each will correspondingly require that the the way it is controlled will be appropriate for its specific circumstances. This chapter discusses critical considerations regarding how ownership and control of a joint venture should be structured.

IMPORTANCE OF EXERCISING CONTROL OVER JOINT VENTURES

Recent research suggests that the control exercised by parent companies over a venture's operations or activities is a critical determinant of joint venture performance.(2) Yet, particularly in comparison to wholly-owned subsidiaries, the exercise of effective control over joint ventures may represent a more difficult managerial task for parent companies because the presence of partners may limit a firm's ability to rely solely on its ownership to determine the venture's behavior and management.

Control refers to the process by which one company influences the behavior of another, through the use of power, authority and other formal or informal mechanisms.(3) Control plays an important role in determining a company's ability to achieve its goals, since it affects the firm's ability to monitor, coordinate and integrate the activities of its various business operations. Without effective control efforts, firms are likely to experience great difficulty in successfully managing their operations.

A company that agrees to participate in a joint venture inevitably complicates its life. Due to the shared ownership and decision making nature of these ventures, each partner must relinquish some control over the joint venture's activities. Yet, such a move is often resisted by parent company managers, for reasons intimately related to their firm's corporate strategy and objectives. Attainment of a firm's objectives over the long term is contingent on its ability to implement a strategy which exploits its distinctive competences along one or several critical dimensions of corporate activity. Insufficient or ineffective control over a joint venture can limit the parent's ability to coordinate its activities, to efficiently utilize its resources and to effectively implement its strategy. In contrast, exercising effective control over some or all of the joint venture's activities helps protect the parent from premature exposure of its strategy, technological core or other proprietary components to outside groups. Even if its products or processes are protected by patents or copyrights, a firm may nonetheless fear damaging "leakage" of unprotected innovations or knowhow if shared with partners. Such disclosures, between the partners or to organizations outside the venture, may have serious effects on the competitive position of a parent or the joint venture, possibly creating new competitors or otherwise limiting the venture's or parent's overall efficiency. Therefore, in order to fully

achieve their strategic objectives, it is essential that parent firms be able to effectively control their joint ventures.

From the parent firm's standpoint, an effective joint venture control system is one which will enable it to achieve its strategic objectives for the venture. However, to be truly effective, the parent must also ensure that this control system will not prevent the other major stakeholders in the venture - particularly the other partner(s) and venture management and employees - from also achieving their strategic objectives. Unless each of the participants perceives that its objectives are likely to be attained, the joint venture is likely to encounter conflicts, performance problems and possibly termination. The mere existence of different objectives between the various stakeholder groups need not mean that these objectives are incompatible. However, if it is apparent that the stakeholders' control requirements are incompatible, then it might be advisable to either pursue a venture without the affected parties, pursue some non-joint venture option (e.g., licensing or wholly-owned subsidiary), or to completely bypass the proposed investment rather than entering into a corporate marriage that is unlikely to work.

In an attempt to exercise effective control over a joint venture, the first concern commonly expressed by managers is how to divide ownership of the venture among the partner firms.

MAJORITY/MINORITY VERSUS 50/50 DIVISIONS OF OWNERSHIP

When determining how the joint venture's equity will be divided among the parent companies, managers typically choose one of the following two alternatives: majority/minority (where one partner has over 50% of the venture's equity) or 50/50 (where the partners have equal or approximately equal shares, and no clear majority of the equity is held by any one partner). An important issue associated with this decision is the impact that ownership may have on how the venture is managed. In the past, a number of consultants have emphasized the importance of being able to control the overall venture, and they frequently prescribed that 50/50 ventures should be avoided whenever possible. Their rationale was that a majority owner would be able to exercise dominant control over the venture, allowing decisions to be made rapidly in response to market or product developments and avoiding the costly compromises or decision making deadlocks which a 50/50 venture might confront. Majority ownership also might limit diffusion of technology or other knowhow to partners or other firms if the dominant partner could exercise tighter control over the venture's activities, and would enable the parent to integrate the joint venture's business into its global strategies and local operations.

Although majority ownership may provide a parent firm with some control, it will rarely enable it to dictate all of the venture's decisions all of the time. If a firm attempts to force its will upon its partners merely on the basis of relative ownership, the venture's prospects for long term survival will be sharply diminished. A majority owner might be able to successfully outvote its partner on critical decisions once, or even twice. However, a minority partner which is systematically outvoted on important issues will feel that its strategic objectives are not being achieved and its trust in the partner's actions and intentions may erode quickly. The result is typically a heightened level of conflict and confrontation, and unless the situation is quickly rectified, such a venture will generally be terminated within a short time.

In addition, the emphasis on controlling a venture through majority ownership fails to take into account the variety of mechanisms available for exercising control, even from the perspective of a minority partner. Since

each partner is essential to the venture's success, even a minority shareholder can exert influence over the operations of a venture. In fact, it is often possible for a minority partner to exercise control to an extent which is quite disproportionate to its relative shareholdings. Nevertheless, regardless of the division of equity, for a joint venture to operate successfully over the long term it must be operated on a "win-win" basis. Demanding majority ownership of a joint venture, and then managing the venture to exploit this ownership advantage, is likely to result in lower joint venture performance.

In contrast, 50/50 equity splits may have symbolic value which enhances the likelihood that the joint venture will work. When both partners feel they have equal positions, they are more likely to feel that each shares equal commitment to the joint venture and are thus more inclined to try to make consensus decision making work. The 50/50 split helps guarantee that both parties' interests are protected, fosters consensus decision making and forces the partners to negotiate as equals in trying to resolve any problems. In addition, although equity may be split 50/50, it may be possible to structure the venture so that each partner retains control over functions which they view as strategically important. For example, it may be possible to clearly delineate the venture's tasks - such as production and marketing - and correspondingly the responsibilities for these tasks. Thus, the 50/50 venture may provide the stable working foundation necessary for the joint venture to work successfully.

Examination of data on Canadian joint ventures provides some interesting support for this argument.(4) At the end of 1988 there were 908 two-parent joint ventures in which one partner had majority ownership, and 1,393 in which ownership was equally divided. In addition, the proportion of newly-formed ventures involving majority ownership had been increasing during the 1980s. Majority-owned ventures constituted only 39% of all joint ventures in existence in 1981, but 48% the ventures formed between 1981 and 1985, and over 50% of those formed between 1985 and 1988. Yet, between 1981 and 1988, equal ownership joint ventures exhibited a significantly higher survival rate (58%) than did ventures with majority ownership (48%). Although admittedly an imperfect measure, survival provides an important proxy for joint venture performance since it represents a basic objective of most, if not all, of these ventures.

Control is a complex phenomenon which can be quite distinct from mere consideration of relative equity ownership. Although majority ownership may enable a parent firm to exercise some degree of control, it often does not ensure full control over the joint venture or even control over the venture's strategically critical activities. Therefore, instead of focusing merely on how the ownership will be divided, the critical concern should be how the joint venture will be managed so that each partner's objectives are likely to be attained. Many of our sample's parent firms discovered that they did not need to exercise control over the entire joint venture, but only over selected dimensions of its activities.

SELECTIVE VERSUS OVERALL CONTROL

Rather than trying to control the overall joint venture, it is often more appropriate for parent firms to selectively target their control efforts toward those specific activities or decisions which are crucial for achieving their own or the joint venture's objectives. This is a particularly important issue when the joint venture's equity is equally divided, or when a parent has only a minority percentage of the venture.

Each parent firm should determine over what dimensions of the venture it needs to have control. This decision will be an outgrowth of the parent firm's strategic objectives for both the short term and the long term, and should reflect the key success factors that are critical to the maintenance of the parent company's competitive advantage, as well as ensuring the economic viability of the joint venture. In identifying these key activities and decisions, it is important to distinguish between what you want and what you need to control, since many executives fall into the trap of believing that more control is always better, and ignore the costs associated with exercising that control.

OPTIONS FOR DIVIDING CONTROL BETWEEN PARENT COMPANIES

There are four principal ways in which control of a joint venture can be divided between parent firms.(5) These options are:

1. Dominant partner joint ventures, in which only one parent plays a dominant role in the joint venture's decision making. Since the presence of two or more parents constitutes the major source of management difficulties in joint ventures, dominant partner joint ventures may help overcome these problems and thus be easier to manage, particularly in comparison to shared management ventures.

2. Shared management joint ventures, where two or more parent companies each play an active role in making the strategic and/or operational decisions of the joint venture, and therefore the extent of interaction between the partners tends to be much higher than with the other control options.

3. Split control joint ventures, in which each parent company or the joint venture's managers exercise dominant control over only one or a few dimensions of the joint venture, and no individual parent (nor the venture's management) controls a clear majority of the joint venture's activities or decisions.

4. Independent joint ventures, in which the joint venture's general manager and other key personnel enjoy extensive decision making autonomy from the parent companies.

No one of these options for structuring control over the joint venture is clearly superior to the others in all cases. Rather, the "best" structure to use depends on the parents' and the joint venture's strategic objectives and needs, as well as the relative costs and benefits associated with the establishment of the joint venture control systems necessary to achieve them. This decision is discussed in greater depth later in this chapter.

BENEFITS AND COSTS OF JOINT VENTURE CONTROL

As suggested, there can be benefits from the exercise of control over a joint venture's operations. Without such control, a parent company may encounter difficulties in achieving the full potential of its strategy and in attaining its objectives. For example, unless effective controls are implemented, an organization's distinctive competences (i.e., its unique abilities to reduce costs or differentiate products) may be unintentionally dissipated due to the opportunistic behavior of its partner or other organizations, thus potentially weakening its strategic position. Control can thus enable the firm to reduce costs and other undesirable behaviors that can potentially limit a strategy's benefits.

However, a parent company's efforts to exercise joint venture control are not without drawbacks; they indeed have a cost associated with them. Control often implies a commitment from a firm in terms of both responsibility and resources, and it may lead both directly and indirectly to increases in overhead and other expenses. Control can also increase the risks to which a firm is exposed, since it may divert an organization's attention and resources from other critical activities. Consequently, exercising extensive control over a joint venture's activities and decisions can generate important coordination and governance costs, and limit the venture's efficiency. This may be especially true for control efforts oriented toward activities and decisions having but minor importance for the performance of either the joint venture or the parent.

The level of costs associated with effective control of a joint venture is related to the level of interdependence between the joint venture and other operations of the parent firm. Other things being equal, parent companies will require the lowest extent and complexity of controls, and thus encounter the lowest required level of costs, when the level of interdependence between their operations and the joint venture is minimized. When interdependence is low, the need for coordination and overhead costs associated with administration and monitoring of joint venture activities is also reduced, as is the associated uncertainty, conflict and other related costs. Under these circumstances, the parent company may be able to limit the control task to the development and application of relatively simple controls, such as performance evaluations based on basic financial and operational measures. However, as the level of interdependence between the joint venture and other operations of the parent company increases, costs associated with effective coordination, monitoring, enforcement and so forth also tend to increase, and frequently at a rapid rate.

SELECTING WHICH CONTROL STRUCTURE TO USE

From the discussion above, it should be apparent that different levels of required costs are associated with each of the four different joint venture control structures: dominant partner, shared management, split control and independent.(6) In general, independent joint ventures tend to have the lowest level of required control costs because they are run in a relatively autonomous manner. Dominant partner joint ventures will evidence the next lowest level of required costs because all or most of the decision making activities are dominated by an individual parent firm, limiting the level of interaction required for decision making. Since only a portion of the decision making activities will be dominated by each partner, more extensive coordination between partners will generally be necessary in split control joint ventures than in dominant partner ventures, and they will correspondingly have somewhat higher levels of costs. Shared management joint ventures generally require greatly increased levels of coordination between parents since each partner participates actively in decisions regarding all or most of the joint venture's activities. Of course, the actual level of costs or benefits of each control structure option depends on the joint venture control mechanisms which are utilized, as well as the effectiveness of their implementation. However, the critical objective for each parent company is to exercise control over a joint venture in a manner that will permit the firm to successfully implement its strategy without incurring a level of administrative or organizational inefficiencies which outweighs the gains from the venture.

Thus, the decision on which control structure to use depends on parent firms' strategies regarding the extent to which the joint venture must be

integrated with their other operations. The extent of integration can be envisioned as a continuum, ranging from a stand alone or independent relationship between the parent and the joint venture (i.e., joint venture autonomy, or minimal or no integration of the joint venture with the parent's other operations), through sharing of resources between parent and joint venture (i.e., sharing brand names, patents, manufacturing facilities, sales forces, etc.), to complete sharing of systems between parent and joint venture (i.e., extensive or complete integration of the joint venture with other parent firm operations. For instance, for the manufacturing function this might go beyond mere sharing of production technology or facilities to also encompass a broader range of "hard" and "soft" dimensions of manufacturing, including problem solving approaches, product development systems linking marketing and R&D with manufacturing, workforce motivation schemes, etc.).

Using this continuum as a base, a matrix can be developed for analyzing the relationship between the extent of integration of a joint venture with its parent firms' operations, and the structural division of parent control. Each of the axes of this matrix consists of the above continuum, with one axis to represent the extent of integration between the venture and each of two hypothetical two parent firms (Parents A and B, respectively). The resulting matrix is shown in Figure 1.

FIGURE 1

RELATIONSHIP BETWEEN EXTENT OF INTEGRATION AND DIVISION OF PARENT CONTROL OVER A JOINT VENTURE

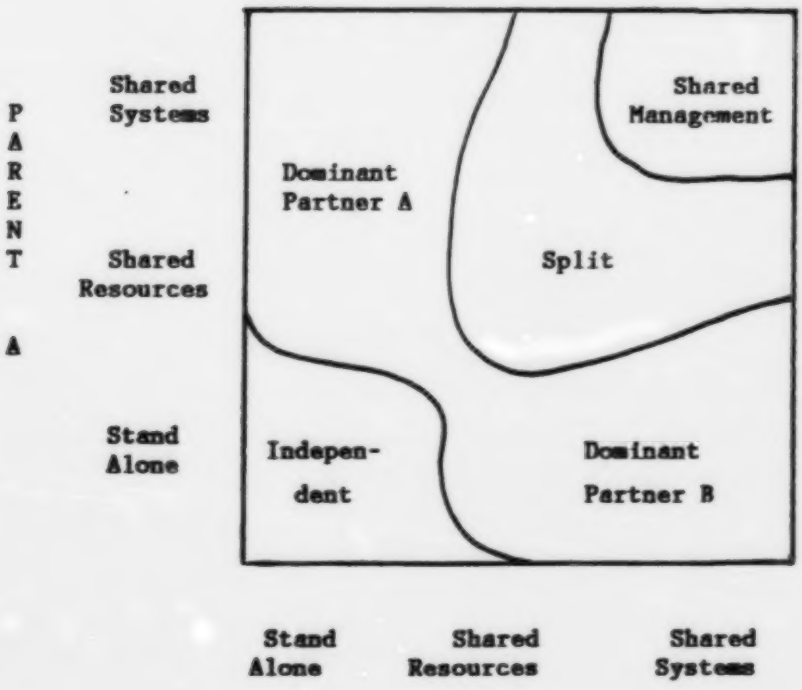

Figure 1 shows that a strategy-structure "fit" is obtained when the parents' division of control structure (and its associated level of costs and benefits) is consistent with the extent of integration between the venture and the other operations of each parent firm. For example, when there is little or no required sharing of resources or systems between the venture and either parent, the optimal control structure would be an independent joint venture, in which the venture's general manager enjoys extensive decision making autonomy. When a venture requires little or no sharing of resources or systems with one partner, but requires a significant amount of sharing or integration with the other partner, a dominant partner control structure is most appropriate (i.e., dominated by parent A or B, depending on which firm the venture will be extensively integrated with). When the venture requires extensive sharing of resources or systems with <u>both</u> parents, but when integration on individual dimensions of the venture's activities is principally required with only a single parent (for example, design and manufacturing is integrated with the operations of Partner A, while marketing, distribution and sales is integrated with Partner B), then the split control structure would generally be most appropriate. Finally, when the venture requires extensive sharing of resources or systems with both parent firms, and when integration on many or all joint venture activities is simultaneously required with each parent, then the use of a shared management control structure is typically warranted.

An important consideration associated with the division of control structure of a joint venture is the level of costs associated with its operation. There tends to be an increase in costs associated with the various division of control structures as we move away from the lower left hand and toward the upper right hand corners of the matrix, in other words, as the extent of resource sharing and integration between the venture and the parent firms increases. Although the matrix suggests which control structure will generally be the least cumbersome and costly alternative for satisfying the parent firms' strategic needs in a particular situation, it is also usually possible for the parents to implement one of the more costly control structures. For instance, the partners may prefer to implement a dominant parent structure when an independent joint venture control structure may suffice, or to implement a shared management joint venture when split control would also be appropriate. However, in making such a choice, it should be recognized that venture and/or parent firm performance is likely to be harmed, due to the increased costs of the alternative control structure (for example, increased costs of administration and conflict, reduced flexibility and responsiveness to market changes, and so forth). In addition, it should be noted that trying to substitute a less costly control structure than is appropriate for the circumstances is also likely to harm performance of the venture and/or the parent firms. For example, effective operation of a particular joint venture may require integration of the venture with Parent A's manufacturing systems and with Parent B's marketing and distribution systems, suggesting a split control structure would be most appropriate. Under these circumstances, utilization of one of the lower cost control structures (i.e., independent or dominant partner) may inhibit the ability of the venture to effectively compete in its markets, and may also limit the ability of one or both parents' to obtain the full benefits of their cooperative endeavor (for example, it may limit economies of scale or scope in marketing or manufacturing, inadequately restrict diffusion of proprietary knowhow to other firms, or reduce financial returns on the joint venture investment).

DIMENSIONS OF EFFECTIVE JOINT VENTURE CONTROL

Yet, identifying which division of control structure to use in the joint venture is only a first step toward successfully controlling these ventures. It is also necessary to design and implement a control system that will allow each parent firm to effectively and efficiently exercise control over the critical decisions. In designing such a system, it is possible to distinguish three dimensions that comprise the foundation of an effective joint venture control system and which are complementary and interdependent.(7) They each examine a different aspect of joint venture control. Parent firms must simultaneously consider all three of these dimensions in order to design and implement effective control efforts for their joint ventures. Failure to do so will often prevent the firm from achieving the full benefits of the cooperative endeavor. These three dimensions are:

1. Focus of Control Efforts

The term "focus" refers to the scope of activities or decisions over which the parent firm seeks to exercise, or not to exercise, control. A parent firm may be able to achieve its strategic objectives by exercising dominant control over only a few activities of the venture rather than attempting to control all of the joint venture operations. This is particularly the case when the parent firm wants to extensively integrate specific activities of the joint venture, such as manufacturing or marketing, with its other operations. Ideally, in order to mitigate the extent of disagreements over who will control the various joint venture activities, the parent will have selected a partner with compatible objectives and complementary skills.

An example of this type of fit is a recently formed venture between a North American and an Asian auto manufacturer to produce a subcompact car. The small car would fill the North American parent's product line, thereby enhancing its economies of scale and scope in marketing and distribution. It would also enable the Asian firm to enhance its manufacturing scale economies by increasing its production volume of drive train components and other key parts, as well as enabling it to increase its North American market presence. While both parties participated in product design efforts, the Asian partner exercised dominant control over purchasing and manufacturing while the North American firm controlled the marketing, distribution and sales of the vehicles.

A parent firm may also specifically desire not to exercise extensive control over a particular activity, such as when the activity is not central to the parent's strategic focus or if the partner has a much stronger competitive position on that particular dimension. Similarly, if efforts to effectively control an activity would entail high administrative or learning costs, or would utilize extremely scarce management time and force the parent to divert its attention from its core operations, then delegation of control to the partner or to the joint venture's managers might be more appropriate.

2. Extent of Control Efforts

"Extent" of control refers to the degree of control exercised by a parent firm over individual activities of the joint venture. It ranges from complete control by one parent, through equal control by each parent and/or the venture's managers, to complete control by the joint venture's managers.

The presence of two or more parents constitutes the major source of management difficulties in most joint ventures. Therefore, when venture

activities are dominated by a single parent or are delegated to the joint venture's managers, they will generally be easier to manage and consequently more successful than when decision making control is shared by the parents. This is because dominant control can reduce the costs and uncertainties associated with coordination of and conflict between parents, as well as the risk of unintended disclosures of proprietary knowhow to a partner firm or other outside groups. However, as discussed above, it may not be necessary for a parent or the joint venture's management to dominate the overall joint venture in order to achieve these benefits. Rather, it may be possible to have a split control structure, where each parent or the joint venture management exerts dominant control over one or several different activities of the venture. Nevertheless, the use of either overall or selective dominant control structures is appropriate only if the controlling party has the skills and resources necessary to meet the market requirements of that activity, such as sufficient manufacturing expertise, financial acumen, or competence and contacts within the marketing and distribution channels.

3. Mechanisms of Control

Control "mechanisms" represent the means by which parent firms exercise control over the joint venture and they may be categorized into two main types.(8) **Positive** control mechanisms, which parent firms employ in order to promote certain behaviors, can be distinguished from **negative** control mechanisms, which are used by a parent to stop or prevent the joint venture from implementing certain activities or decisions. Positive control tends to be exercised through informal means, including staffing, reporting relationships, participation in the planning or capital budgeting process, and business or social visits to the joint venture. In contrast, the more bureaucratic negative control includes reliance on such devices as formal agreements, approval or veto by parents and the use of the venture's board of directors.

Although their value is seldom fully appreciated or exploited, human resources often represent a crucial strategic control mechanism for a joint venture parent. For instance, even if it is a minority partner, a parent may be able to influence control over a joint venture by influencing staffing of the venture's top management positions. As discussed in Chapter 6, the means of selecting, training, evaluating and rewarding the performance of general managers and other key personnel in the joint venture, as well as parent company employees who interact with the venture, can significantly affect not only the venture itself but also its relationship with each parent. The joint venture general manager's position, in particular, can affect the venture's operations since the general manager is responsible for maintaining relationships with each of the parents, as well as running the venture. The relative power of the general manager's position is influenced by the governance structure established by the parents and can range from autocratic (individual dominant control), to participative (participation, though not necessarily voting rights, of a number of managers in the decision making process), or even democratic (sharing of decision making control among many managers).

In addition, human resources can be a critical control mechanism due to the effect they may have on the type and extent of intended and unintended transfers which occur between the partners. For example, the basis for a firm's competitive advantage often resides in non-patentable knowhow or knowwho, which means it is contained in the firm's people. Despite legal devices such as secrecy agreements, it may be possible for specialists who closely analyze a partner's files, plants and overall operations, and who talk

with the company's employees, to understand underlying secrets and how everything fits together. Thus, through proper staffing and training of key venture positions, it may be possible to transfer basic concepts that comprise the basis of one firm's competitive advantage to another partner in the venture. Given the importance of this and other control mechanisms, parent firms should extensively examine these variables in order to enhance their understanding and effective management of joint venture control. Historically, this has often been overlooked.

Parent firms must simultaneously consider all three of the above dimensions of control in order to design and implement effective control efforts for their joint ventures. Failure to do so will often prevent the firm from achieving the full benefits of the cooperative venture. Nevertheless, it appears that many executives concentrated their attention on managing only one or two of these dimensions, particularly the focus and extent of control, and largely ignored the critical role played by control mechanisms. As a result, many of the firms discovered belatedly that the joint venture control systems they had implemented were inadequate, and that their competitive position had been unintentionally compromised.

ACHIEVING AND MAINTAINING A CONTROL "FIT"

The critical issue for a parent firm is to exercise control over a joint venture, in terms of focus, extent and mechanisms, in a manner that allows the parent to successfully implement its strategy without incurring a level of administrative or organizational inefficiencies that outweighs the gains from its cooperative endeavor. There is a "fit" between the parents' strategies and the joint venture's control structure when the benefits outweigh the costs of control, and this "fit" is best when the margin between benefits and costs is optimized. For instance, consider the case of a French firm that had developed and successfully commercialized a line of household goods in Europe and wanted to expand its operations into North America. Because of its limited experience and resource base, it decided to form a joint venture with a successful Quebec firm with a complementary product line and strong market presence in Canada and the U.S. Until market demand was clearly established, the products were to be imported from Europe. In addition to controlling manufacturing during this initial stage, the French firm, in order to protect its interests and to ensure effective strategy implementation, wanted to exercise at least a moderate level of control over the joint venture's market development efforts. The extent of control which the French partner wanted to exercise, however, threatened to limit the autonomy and flexibility of the joint venture and its managers, hindering the venture's ability to respond to local market demands and generating a level of administrative costs that threatened to offset the venture's potential strategic benefits. In this case, achieving a control "fit" entailed a <u>reduction</u> in the extent of control which the French partner wanted to exercise.

Sometimes, to maintain this "fit," it is necessary for the control structure to evolve over time. This evolution may be in response to the joint venture's performance (either strong or poor), to changes in the venture's environment, or to changes in the venture's internal operations or strategic requirements. For example, a German auto parts manufacturer formed a joint venture with an Ontario firm to supply auto subassemblies in the North American market. From a strategic standpoint, the German firm's principal objectives were to exploit its technical expertise in product design and manufacturing, as well as achieving increased economies of scale in the production of key components, while overcoming the constraints imposed by its

limited market presence in North America. The Ontario partner had existing supply relationships with several of the major North American auto firms and the infrastructural support and expertise necessary to manage a Canadian workforce, but wanted to significantly improve its manufacturing technology. At first, to ensure effective technology transfer, the German firm exercised very tight control over the venture's Canadian manufacturing operations. It insisted on designing the layout of the venture's plant, and sent a team of engineers to Canada to oversee the installation of equipment and to help train employees. A number of Canadian employees were also sent to Germany to view the partner's operations and to receive additional training in the manufacturing technology. During the joint venture's first year, the German firm maintained close supervision over the Canadian operations to minimize the defect rate and ensure that the skill transfer was successful. After that time, control of manufacturing shifted to the Ontario partner and the venture's managers. Although the German parent keeps a technical manager on-site, the person functions in more of an advisory than a decision making capacity. Thus, as the needs of the joint venture changed over time, the control structure also changed in order to maintain a fit with these evolving strategic requirements.

ENDNOTES

1. Portions of this chapter are adapted from J. M. Geringer and P. Woodcock, "Ownership and Control of Canadian Joint Ventures," Business Quarterly, Summer, 1989.

2. For example, see L.G. Franko, Joint Venture Survival in Multinational Corporations, New York: Praeger, 1971; J.P. Killing, "How to Make a Global Joint Venture Work," Harvard Business Review, May-June, 1982, pp. 120-127; J.L. Schaan, "Parent Control and Joint Venture Success: The Case of Mexico," unpublished doctoral dissertation, University of Western Ontario, 1983; P.W. Beamish, "Joint Venture Performance in Developing Countries," unpublished doctoral dissertation, University of Western Ontario, 1984; and J.M. Geringer and L. Hébert, "Control and Performance of International Joint Ventures," Journal of International Business Studies, Summer, 1989, pp. 234-254.

3. J.M. Geringer and L. Hébert, "Control and Performance of International Joint Ventures," Journal of International Business Studies, Summer, 1989, p. 236.

4. The data in this section are excerpted from J.M. Geringer, TRENDS AND TRAITS OF CANADIAN JOINT VENTURES, Ottawa: Investment Canada, forthcoming, 1989.

5. See J.M. Geringer and L. Hébert, "Control and Performance of International Joint Ventures," Journal of International Business Studies, Summer, 1989, pp. 234-254, and J.P. Killing, "How to Make a Global Joint Venture Work," Harvard Business Review, May-June, 1982, pp. 120-127.

6. Adapted from J.M. Geringer, "Parent Strategy and Division of Control in International Joint Ventures," Proceedings of the Administrative Sciences Association of Canada, Montreal, 1989

7. J.M. Geringer and L. Hébert, "Control and Performance of International Joint Ventures," Journal of International Business Studies, Summer, 1989, pp. 234-254.

8. J.L. Schaan, "Parent Control and Joint Venture Success: The Case of Mexico," unpublished doctoral dissertation, University of Western Ontario, 1983.

CHAPTER 6

STAFFING AND MANAGEMENT OF THE VENTURE

The preceding chapters have each addressed issues associated with the formation of joint ventures. These issues are critical, since inappropriate motives for and design of a venture are likely to result in poor performance. However, management of the venture also represents a crucial concern for parent firms. In fact, many of the performance problems experienced by joint ventures have been linked to the unique managerial requirements of these ventures and may be only partially mitigated through effective venture design.

Clearly, successful management of joint ventures often represents a major challenge to all of the parties involved in the venture. Each venture is unique in its own way, and correspondingly each must be managed in a manner appropriate for its specific circumstances. As with every other aspect of a joint venture, the management of the venture is subject to negotiation. The fact of shared ownership and decision making often serves to significantly complicate the management of joint ventures as compared to more conventional forms of ownership. Thus, effective management practices and procedures are critical in order for the venture to satisfy its parents' objectives.

This chapter addresses several key issues associated with staffing and management of joint ventures, including management of the venture's human resources, parent-joint venture relations, and managing changes over the venture's life cycle.(1)

MANAGING HUMAN RESOURCES

Effective management of human resources represents perhaps the most important task in operating a successful joint venture. Although good design is a prerequisite for successful venture operations, it is people that implement the venture's strategy and recent studies suggest that many IJV performance problems result from poorly designed and executed human resource management strategies. Yet, companies often fail to adequately plan for and utilize human resources in their joint ventures. For example, a recent Coopers & Lybrand study found that, of the 100 to 5,000 hours typically involved in creating these alliances, only about 4 percent of the time has been spent resolving human resource-related issues.(2) The strategic importance of this point should not be overlooked, since there may be limits to how much can be gained from even majority control of a joint venture if authority over human resources is fully abdicated to the partner or to the venture's management. Thus, if parent companies are to more effectively manage and control joint venture operations, recognition of the use and importance of human resource management techniques appears warranted. Four human resource techniques - recruitment and staffing, training and development, performance appraisal, and compensation and reward - and their relevance for joint venture management are discussed in this section.

Ideally, the main issues associated with management of the venture's human resources should have been addressed during venture negotiation and incorporated into the joint venture agreement. Decisions on these issues are intimately linked to the venture's strategic objectives, management style and culture and should not be viewed lightly. Rather, by anticipating the needs

of the parents and venture, and resolving differences prior to its formation, it is often possible to reduce the incidence of ambiguity and conflict and thus enhance the functioning of the venture.

Recruitment and Staffing of Venture Personnel

Recruitment and staffing of joint venture management and employees is a major determinant of venture performance. Regardless of how recruitment and staffing is conducted, you must not lose sight of the fact that the venture itself must be able to function as a viable business. As a result, it is essential that the venture not become a dumping ground for mediocre personnel who lack the drive or skills required by the venture. An individual should also not be chosen for the venture merely because he or she is one of "our" people. Rather, each of the venture's personnel must have the technical, organizational and interpersonal skills necessary to ensure the successful operation of the venture and thus to satisfy the partners' objectives. Particularly for the venture's executives, the personnel must have the drive and commitment necessary for making the venture work, as well as the ability to recognize and respond to the unique managerial challenges associated with joint ventures. These individuals must also be capable of understanding, and functioning effectively within, the different national and corporate cultures which often constitute a venture's operating environment. Unless these capabilities are present, it will be difficult to secure the trust, respect and influence necessary to successfully manage the venture.

Some firms resist letting their sharpest managers and technicians move to a joint venture. Yet, using the venture as a training ground for junior managers can prove costly unless adequate safeguards are put in place. These junior employees often lack the requisite managerial and interpersonal skills to function effectively inside the venture or to wield influence with parent firm executives. As a result, not only may the joint venture's prospects be damaged, but also the career development of the junior managers.

When recruiting individuals for the joint venture, particularly for the senior management positions, firms have often found it valuable to employ a recruitment approach which includes a realistic job preview as well as personnel techniques such as tests and simulations which assess the fit of the individual with the demands of the venture's operations. Realistic recruitment presents candidates with all pertinent information about their prospective jobs, without distortion. The objective is to give candidates a small dose of organizational reality during the recruitment stage in an attempt to reduce the incidence of unrealistic initial job expectations. This approach has proven effective in increasing initial job satisfaction and reducing turnover. Given the many challenges which commonly confront employees working in a joint venture, such as often conflicting demands of dual parents, complexity and multiplicity of goals, and multiple cultural and language differences, realistic recruitment can be an effective tool for helping select individuals who will work effectively within, and cope with, these challenges.

<u>The joint venture general manager</u>. The venture general manager's position, in particular, can affect the operations and performance of a venture. The role of the joint venture general manager typically differs from that of a GM in a wholly owned subsidiary, and a strong argument can be made that the role of the venture GM tends to be much more difficult. Role conflict, ambiguity and overload are inherent to the practice of management. However, for venture GMs, these factors are typically magnified. Problems such as the presence of two or more parents, geographic as well as cultural distance, and divergent sets of expectations, goals and desired performance outcomes provide major

challenges to venture GMs. Yet, particularly for the more independently run ventures, newly appointed GMs often have little in the way of guidelines or support systems to help them into their new jobs, and they consequently encounter greater difficulty in being effective. By the job's very nature, the joint venture GM is an outsider to at least one of the parent firms. In addition, since the parent firms themselves are often unsure of the exact form the venture will take, providing appropriate training and other support to the new GM is often not possible. Furthermore, since a major impetus for joint venture formation is rapid market entry and exploitation of products or technologies during the early stages of their life cycles, the new GM must take quick and decisive action within an environment characterized by inadequate information and nonexisting relationships. As a result, the new manager is forced to be more self-reliant than in a corresponding intrafirm job.

How much autonomy the venture's general manager will be able to exercise should have largely been determined during the venture negotiations. However, the degree of actual independence will depend heavily on the traits of the individual who is chosen. It is critical that the candidate is competent, experienced and has goals consistent with those of the parents. In addition to the skills necessary to set up and manage the venture, the GM must have the personality, vision and leadership skills necessary to inspire confidence and to motivate personnel drawn from different business cultures; to excel at networking internally and externally; and to satisfy the often divergent interests of the parents. Furthermore, it will generally be necessary for the GM to evidence stronger skills in networking, diplomacy and cultural sensitivity than might be the case for a wholly-owned subsidiary.

The ability to appoint the venture's GM may sometimes increase the prospects for a parent's interests being observed, but it is no guarantee that the GM will always accommodate the parent's desires. The venture GM can not give systematic preference to the well-being of any individual parent, and attempting to appoint a manager who will operate in such a biased manner is likely to destroy the operating relationship between the partners, and possibly prevent the venture itself from being viable. It is essential that the person selected have the ability to recognize and understand the objectives of each parent; the diplomatic skills to manage conflicts which may arise due to differences between the parents' objectives; and the strength of personality necessary to maintain an objective and unbiased management style.

Often, the GM will be chosen from a list of internal candidates, and he or she will often have participated in the venture negotiations. This enhances the GM's ability to understand each partner's objectives for the venture, as well as building communication and trust with parent company management. However, in case no suitable internal candidate exists, the parents should also consider outside candidates and avoid making any compromises regarding the quality of the candidate who is ultimately selected. The position is key to performance of the venture, and it may be better to terminate the venture formation process rather than to appoint a GM who lacks the necessary capabilities.

Other members of the venture's management team. Staffing of the remaining members of the venture's management team is usually the responsibility of the venture's GM, subject to ratification by the parents or the venture's board. Yet, it is also common for parents to seek to staff specific positions within a venture. For example, when the GM is hired from one of the parent organizations, the other parent will often appoint the venture's senior financial officer or the second most-senior manager. It is also common for a parent to appoint the senior manager for functional activities, such as

marketing or manufacturing, which are integral to the maintenance of the its competitive advantage. In making such appointments, it is essential that these individuals have the capabilities to perform their respective functions, as well as being able to form effective working relationships with the joint venture's general manager. It is often advisable to have the GM participate in the selection process, if only to select among finalists for a particular position.

Non-management employees. The characteristics of the technical personnel who are recruited for the venture influences the extent of technology transfer, both intended and unintended, between partner organizations. Since critical technology often resides in non-patentable knowhow or knowwho, careful staffing of these key positions may enable a parent or joint venture to more rapidly learn from the partner company and transfer the basic concepts necessary for establishing and maintaining competitive advantage. These lower level employees were the source of many problems in our sample joint ventures, due to different operating styles and philosophies of engineering, technical or manufacturing employees from the parent firms. Therefore, to avoid these problems and facilitate smooth venture operations, the people selected for these positions should evidence strong technical and interpersonal skills, receptivity to new ideas, and the ability to disseminate what they have learned throughout the organization.

Key positions in parent companies. The importance of joint venture champions, who promote the venture within the parent firm as well as serving as liaisons between the parents and the venture, was discussed in Chapter 4. Selection of champions who have the requisite technical competence, organizational authority and interpersonal skills is a key to successful formation and management of a joint venture. Furthermore, the presence of more than one champion, and maintaining continuity among these individuals, typically enhances prospects for a successful venture by promoting trust, communication and continued enthusiasm between the partners. Indeed, there is value in having a hierarchy of alliance champions. This permits people to be trained as senior champions while others are in the later stages of their service, thus providing for continuity and succession among champions and providing regular career pathing for these managers. This can reduce managers' disincentives to take on the task and increase the quality of the champions. In addition, this hierarchy may enable the venture to be championed throughout the organization, especially at the middle levels where ambiguity, uncertainty and frustration tend to be the highest.

In addition to full time management personnel, parents often form either formal or de facto teams of managers to provide advisory assistance during venture start-up. For example, it is common to provide engineering or other technical assistance to facilitate transfer of technology by assisting in initial set-up of machinery and training of employees in its use. In some cases, these management teams will provide continued interaction and support long after venture start-up. For example, if the joint venture's operations must be integrated with the parent's, or if technology transfer occurs on a continuing basis, then maintenance of this support is critical.

Training and Development Programs

Employee training and development includes any attempt to improve current or future employee performance by increasing, through learning, an employee's ability to perform, usually by changing the employee's attitudes or increasing his or her skill level and knowledge. When implemented correctly, training and development can remove performance deficiencies, thereby improving the

employee's ability to perform better and allowing the organization to be more effective. In fact, these programs offer such great potential in promoting joint venture performance that it has been recommended that a formal policy regarding the form and content of training and development be addressed in the venture negotiations and legal agreement.(3)

Formal in-house training and development programs tend to be less common for smaller parent firms or joint ventures, who instead tend to utilize outside firms for providing these programs. Yet, whether the training is done by a parent, by someone in the venture or by an outside firm, the content of the training program is the critical concern. Many training programs fail to adequately address the problems which confront the trainees, and thus do not have any beneficial effect on performance. In order to be effective, it is critical that training be specific to the trainees' location, customs and way of thinking, as well as to the actual problems which are being confronted. Therefore, it is usually valuable for the personnel from the joint venture, and often from parent companies as well, to participate in identification of the issues which must be addressed, as well as in formulation of a training program which would overcome these problems. It may also be necessary to implement a monitoring system, possibly in conjunction with the venture's performance evaluation process, to assess the effectiveness of the training program and any modifications which might be necessary over time.

Training can serve many functions in a joint venture, including socialization through language and cultural training, corrective action by identifying and reducing errors in performance, and developmental activity through teaching employees new skills for a current or a different job in the organization. For example, particularly when the venture requires staffing of management positions with technical personnel, these individuals often require management training. As one executive commented, "They need to learn people skills. It's not anything they can't learn, but it's something you can't ignore when moving them into management positions. We teach them people-manager skills, cultural sensitivity, project planning, how to organize, how to resolve conflicts, how to hire and fire, things they generally don't do as engineers." Training programs are also often developed to help venture employees effectively implement key technologies within the joint venture as well as reduce diffusion of technology to outside firms, thus helping maintain the parent's or venture's competitive advantage. Similarly, orientation and on-the-job training programs may be designed for new staff of the venture. These programs can facilitate organizational socialization by introducing and reinforcing the policies of the venture, both formal and informal, in a series of training and information sessions. Since it is possible for personnel at top, middle and even lower levels to sabotage a joint venture, the use of training and development programs can help overcome this threat by increasing employees' commitment to the venture's success. These programs can also be used to reduce dissension and promote attainment of each partner's objectives by improving employees' understanding of the partners' cultures, objectives and business practices.

Development of programs for job retraining and implementation skills training have also proven effective in improving the expertise and effectiveness of ventures' employees, and thus of venture performance. These programs have ranged from such basic techniques as the use of informal, face-to-face meetings or phone calls, or the promotion of informal mentoring relationships, to the development of extensive formal management or employee development programs. For example, one group of consultants developed a simple, 12-hour self-management training program for venture GMs and other key employees that enhances the individuals' self-efficacy and their venture's performance.(4) In addition, due to the need for venture managers to network

with many different managers in each parent company, as well as within the venture itself, providing these managers with training in interpersonal skills has also improved performance. Similarly, since many joint venture issues are resolved through persuasion and negotiation, several parent firms were able to influence venture operations by training venture managers or key parent company employees in negotiation and conflict resolution skills. Furthermore, joint ventures offer the opportunity for a firm to improve its operations by observing how another organization operates, such as in managing R&D or business development programs, management of export operations or overseas subsidiaries, or even formulation of effective human resource practices. Yet, institutionalized learning does not occur automatically, and training programs can be developed to facilitate transfer of this knowhow between parents or to a joint venture.

Performance Appraisal

Performance appraisal is a formal, structured system of measuring and evaluating an employee's job-related behaviors and outcomes. Appraising employee performance is important because it provides information about how well jobs are being performed and objectives are being met. It also identifies who is responsible for completing specific jobs, and how well they are performing them.

Performance appraisals serve many specific purposes, including management and staff development, performance improvement and compensation. Performance appraisals can provide a framework for future employee development by identifying and preparing individuals for increased responsibilities. In addition, appraising employee performance encourages continued successful performance and helps to identify and overcome individual weaknesses to make employees more effective and productive. It also allows parent firms to monitor progress toward attainment of critical venture objectives. Finally, performance appraisals help determine appropriate pay for performance and the provision of equitable salary and bonus incentives based on merits and results. Although it may not be appropriate to use the same evaluation procedures for joint ventures as for wholly-owned activities, the infrequency with which joint ventures occur in most firms works against such adaptations, to the potential detriment of the venture's employees.

Parent companies can influence joint venture performance by establishing and reinforcing expectations for the venture's operations through the purpose, method and frequency of performance appraisal which is employed. The performance criteria which should be used will depend on the specific circumstances of the joint venture. It is common for parents to have different objectives for establishing a joint venture, and thus to want to apply different evaluation criteria. Yet, different does not necessarily mean incompatible, and it is generally possible to transform these objectives into a set of consistent criteria upon which the venture GM's or other staff members' performance appraisals may be based.

For the parent or joint venture manager(s) who assume control over the performance appraisal function, a number of critical issues should be considered. First, the GM and his or her staff should be educated on the type of performance appraisal being conducted, as well as how often and for what purpose they are being evaluated. Once the purpose of the appraisal is established, career planning issues, alternatives for retraining, and equitable compensation and rewards should be devised based on the outcomes of the performance appraisal. Next, those doing the appraising should be trained in the proper appraisal procedure. It is advised that mutual agreement with the venture GM and staff, as well as with the partner(s), be reached regarding performance criteria and standards to be achieved. When possible, criteria

should be explicit and unambiguous. Emphasis should be placed on the individuals' key tasks and assignments, as well as on non-routine tasks that are critical to the venture's success. Performance appraisals also should not be used strictly in a reward/punishment manner. Instead, they should serve to identify strengths and weaknesses so that training and development programs can be tailored to the employees' needs. Most importantly, the performance appraisal should be tied to the venture's long range planning process. Short and long term objectives should be incorporated into the performance appraisal, which should remain flexible and responsive to market and environmental contingencies. In order to maintain the effectiveness of a performance appraisal system, it must take into account problem areas beyond the control of the venture employee being evaluated. Furthermore, it is advisable to periodically review the objectives of the venture and the parent firms, as well as to reassess the political, economic, competitive and business conditions which confront the venture. As changes in objectives or operating conditions arise, it may be necessary to respond to these changes through modifications in the performance appraisal criteria.

Performance appraisal systems may be effectively used with both managerial and nonmanagerial employees of the venture, as well as with key managerial and support personnel from the parent companies. Thus, the parent company may be able to influence the venture's strategies and goals by ensuring that specific objectives or controls are incorporated within the performance appraisal system, and that specific reward outcomes are contingent upon good performance evaluations. Yet, despite the potential benefits from using performance appraisals, as few as 22 percent of parent firms use these reviews as a measure for enhancing joint venture health.(5)

Compensation and Reward Systems

Compensation includes those rewards - monetary and nonmonetary, direct and indirect - that an organization exchanges for the contributions of its employees, both job performance and personal contributions. In order for parents to effectively use compensation - particularly pay - to increase joint venture performance, its importance to the target employees must be known. The purposes that a company hopes to accomplish through compensation must also be determined. The three major organizational needs that compensation addresses are the attraction of potential employees to the organization, the motivation of employees to perform, and the retention of good employees.

In designing a joint venture's compensation and reward system, it is essential that the system be balanced in terms of internal equity and external competitiveness in order to attract and retain qualified and committed personnel. The system should be sufficiently flexible that consistency may be maintained across the competitive, organizational and cultural environments the individuals will be working in, and the establishment of explicit links between the venture's strategic objectives and employee rewards is often useful. As part of an effective compensation and reward system, and to provide the basis for effective performance appraisals, it is essential that the system's objectives and procedures are able to be clearly and consistently communicated to, and understood by, the venture personnel. The system must also be affordable in both the short and the long run, be easy to implement, and be responsive to organizational change.

It may be both unnecessary and undesirable to use the same reward system in the joint venture as is employed by the parent firms. Particularly if an objective is to orient employees' loyalty first and foremost toward attainment of the venture's objectives, different sets of behavior may be required from joint venture personnel and thus differences in reward systems will be necessary. In addition, since the required behaviors may vary over the course

of a venture's life cycle, it may also be necessary to monitor the compensation and reward system over time, and to modify it accordingly.

The use of compensation to promote joint venture performance may take several forms. One strategy is to explicitly tie an employee's bonus, and possibly his or her career path within the parent's overall operations, to the attainment of the venture's long term strategic objectives. This approach encourages employees to develop an unbiased and undivided allegiance to the joint venture. Yet, parent objectives can simultaneously be promoted if each parent ensures that the venture's goals are consistent with their own and are not inconsistent with the other parent's objectives. Furthermore, in addition to directly managing the venture's employees, it is often possible to influence joint venture performance through the use of compensation and reward systems with key parent company employees. For example, several parent companies in our sample tied the bonuses of their managerial representatives and other key personnel to the effectiveness of the assistance they provided in the formation or management of their joint ventures.

PARENT-JOINT VENTURE RELATIONS

Instilling an Independent Spirit within the Joint Venture

Many of the executives we interviewed argued that a joint venture has the best chance of performing well and achieving the parents' objectives if it is able to develop its own identity and culture, one which is appropriate to its specific circumstances, rather than merely becoming an extension of the culture of a parent firm. This can be a difficult task, since it may require a reorientation of employees' loyalties as well as new policies and procedures. However, this task can be promoted by providing the venture with separate facilities, often in a different province or city from the parents, in order to reduce the incidence of undesired management interference. However, sometimes this is not feasible. For example, one of our sample joint ventures involved the manufacture of petrochemicals and, since its raw materials were sourced from the existing petrochemical complex of one of the parents and transportation of these materials was not economically feasible, the venture had to be located contiguous to the parent's operations.

The venture can also be imbued with an independent spirit through the development of separate incentive and pension programs. As noted earlier in this chapter, such a tactic can help orient employee loyalty toward attainment of the venture's objectives rather than those of the parents. In addition, one of the benefits of staffing some of a venture's positions with employees from outside the parents' operations is that development of a unique, independent venture culture can be enhanced.

The joint venture must be permitted sufficient autonomy, particularly on day-to-day operational issues, in order to develop an independent spirit and achieve its operational objectives. It must avoid being stiffled by the bureaucracy of its parents, particularly requirements for multiple levels of approvals and glacial decision making processes. Yet, the venture's management team must also receive the same high level of attention reserved for managers of the parents' wholly owned businesses. Often, ventures are not treated as full members of a parent's "family" and receive only limited support and encouragement. Signalling that the venture is not considered important to the parents often causes the morale and motivation of venture employees to decline. In addition, the ability of the venture to tap the infrastructure and resources of the parents may be diminished, since parent managers also recognize that the venture is a low priority. As a result, survival of the venture may be compromised. Therefore, it is critical that parent and joint venture managers achieve the fine balance regarding when, how

and in what form support from the parent firms will and will not be provided to the joint venture.

Establishing Communication Links

The establishment of communication links between the joint venture and the parents is critical in order to foster trust and maintain commitment. It is essential that the parents are kept informed about the joint venture's progress and that surprises are avoided. Parent company managers, particularly those who may be less than enthused about the venture, must be shown that continued participation is still in their best interests. This requires the creation and management of multiple relationships, and potential allies, in each parent. Similarly, in order to maintain understanding of the venture's operations, as well as to influence the way the venture is run, parent managers must also ensure that these links are developed and constantly reinforced.

Building these links requires planning and hard work, particularly when the venture involves parties with different languages, cultures and operating styles. A clear communication structure must be developed, detailing contact points and people in each parent organization. This is particularly critical as the scope of the venture's products, markets and functions increases, as well as when extensive sharing of information is required between the parties. Utilization of frequent formal and ad hoc meetings helps avoid surprises or duplication of efforts, provides a forum for monitoring progress toward goals, promotes cross-fertilization of ideas, encourages similar perspectives and solidifies relationships. These meetings may be encouraged for various organizational levels of the parents and joint venture, including the lower operating levels. Furthermore, particularly during venture start-up when the stress of deadlines tends to be greatest, frequent informal visits may be encouraged as yet another means of facilitating communication and monitoring potential problems. The joint venture champions, from the various levels in the organizations, often play key roles as liaisons in promoting these communication links.

Resolving Conflicts

Despite concerted efforts at effective design and management of a joint venture, conflicts between the parents or between a parent and the joint venture almost inevitably arise. Issues which commonly produce disagreements include the timing and size of dividends, export policy, amounts and type of venture financing, transfer prices, choice of suppliers, growth versus profit objectives, the role of each parent in the venture's management, and criteria to employ in evaluating performance. Sometimes these conflicts can be readily overcome by reference to the MOU or the formal joint venture agreement. In other cases this is not possible and the disagreement may be so great that it risks deadlock and subsequent paralysis of the venture. Due to the potential repercussions, it may be worthwhile to develop specific mechanisms for resolving conflicts. These mechanisms may be designed to operate at different levels or on different types of issues. One option is to clearly delineate final authority over decisions on a functional, product or geographic basis. Firms may also have a neutral third party or minor shareholder serve as a tie breaker. However, this practice was criticized by several executives who found it absurd to let someone with little or no stake in the process make decisions with major strategic implications for the parents. Other options include the use of an arbitrator or the court system to resolve the deadlock.

A drawback of formal mechanisms for breaking deadlocks is that their mere existence may decrease incentives for compromise and thereby increase the frequency of deadlock votes. Furthermore, since there tends to be a "loser"

to the process, recourse to these mechanisms may set the stage for the ultimate termination of the venture. Yet, the potential for deadlock and venture paralysis may also function as an incentive for the parties to negotiate an amicable solution. Concern with potential deadlocks also reinforces the potential benefits of programs for training joint venture and parent company managers in interpersonal skills, effective listening, and negotiation and conflict resolution techniques. Ultimately, the specific circumstances of the venture and its participants will dictate what is likely to work best and, because they can be useful in resolving certain problems, the inclusion and use of tie breaking mechanisms should not be entirely disregarded.

MANAGING THROUGH THE VENTURE'S LIFE CYCLE

Start-up of the Venture

For many of this study's participants, the start-up phase of the joint venture involved the greatest challenges. Implementation problems were often reduced substantially by careful up-front planning and venture design. Yet, no matter how much the parents tried to prepare, the early stages were often much rougher than expected. The pressure of deadlines and the need to integrate different cultures and activities in a short time period often challenged even the best working relationships. Indeed, many of the joint venture "divorces" were directly or indirectly traceable to problems which arose during the start-up phase.

Venture start-up typically demands large amounts of cash and other inputs, and can therefore strain the often limited resources of a new venture. It may be possible for a joint venture to substantially reduce these start-up costs by leveraging off of its parent firms' infrastructural skills and resources. The use of service contracts and personal relationships to obtain needed expertise or other inputs may permit the venture managers to slash time to start-up, overcome delays, reduce the amount of resources required and shorten the time to breakeven. Yet, these techniques must be carefully managed in order to generate their potential benefits. In addition, the patterns of cooperation established at this stage form the basis for the parties' future behavior. Therefore, it is critical that effective communication systems be quickly established in order to facilitate cross-fertilization of ideas, avoid duplication of effort and maintain the venture's focus. It is also critical that partner companies' executives clearly communicate the extent of their commitment. This commitment provides a signal to the rest of the organization that they should assist the venture employees during this difficult stage.

Managing the On-Going Venture

Once a joint venture has begun, the parents must be able and willing to make compromises and adapt to changes. For example, although much of the allocation of control is determined during venture negotiations, the mix may be modified over time as parents learn where they can best contribute to venture performance and as trust is built up between the partners. In addition, many ventures will not continue to deliver the benefits originally envisioned. Poorly performing ventures may often be turned around by redesigning the control systems to be more effective. The parents must therefore be prepared to tighten - or loosen - the degree of control as circumstances warrant.

One means by which parent firms may be able to maintain or alter control over a joint venture is by implementing changes in the senior personnel of an on-going venture. Firms have often found it necessary to implement personnel

changes in a venture as it evolved through the different stages of its life cycle, or if it was failing to satisfy the performance objectives of one or more of the parent firms. However, if rotation or replacement of employees is too frequent or too widespread, management continuity and essential relationships among the partners and the venture may be harmed. Parents may also be able to modify the venture's operations by altering the focus or extent of each partner's or the venture managers' control activities. For example, as venture managers establish a proven track record it may be possible to grant them increased autonomy over specific decisions or activities, such as research, marketing or capital investments.

Parent companies should be aware that the circumstances and objectives of the partners themselves are also likely to change over time. As these changes occur, the chances of any one partner being fully satisfied diminish. Sometimes these changes will require a change in ownership or management control to ensure that the venture continues to flourish. The partners must be willing to recognize and adapt to these changes, since rigid adherence to the original agreement may condemn a venture to an early death. For example, two Ontario firms joined forces in a 50/50 joint venture to produce plastic products in the Western provinces. Neither parent had other operations in the West, so they agreed to let the venture operate autonomously. However, over time, one of the parents (Partner A) established several other related ventures in the West, while the other partner retained its focus on the Ontario market. Partner A wanted to integrate the joint venture's manufacturing and sales activities into its other operations in order to achieve greater efficiency. As a result, the shareholdings were changed to 75/25 and Partner A began exercising more direct control over the venture's operations.

Termination of the Venture

Termination is a natural part of the life cycle for many joint ventures. Indeed, 48 percent of the Canadian joint ventures in existence in 1981 had been terminated by 1988.(6) Yet, success is not always easy to gauge and termination need not be equivalent to failure. Although changes often occur in a venture or its parent companies which reduce the attractiveness of continuing the cooperation, this may have little relevance to the relative success of the venture. A joint venture may not be successful on a commercial basis, yet it may have achieved its parents' strategic objectives, such as in promoting technology development or in providing a captive customer for the parents' products. Conversely, a venture may have been profitable, yet may have failed to satisfy other parent objectives or even generated substantial costs such as diffusion of technology and creation of a competitor. In addition, a venture may have been satisfactory for one parent, but not for the other.

The manner in which a joint venture is terminated can have important implications for the parents' future ability to form joint ventures or other collaborative alliances with the same or different partners. It can also affect a firm's ability to recruit qualified personnel for future ventures. In fact, several of our respondents noted that there were certain companies in their industries that were commonly known as "bad" partners or employers because they tended to take advantage of their mates or employees and then leave them out in the cold. For this reason, careful design of termination clauses during negotiations, including minority protection clauses, can facilitate the graceful buyout or liquidation of a joint venture.

ENDNOTES

1. Portions of this chapter are based on J.M. Geringer and C.A. Frayne, "Using human resources to control international joint ventures," working paper, School of Business Administration, University of Western Ontario, 1989; and C.A. Frayne and J.M. Geringer, "Self-management training for general managers of international joint ventures," working paper, School of Business Administration, University of Western Ontario, 1989.

2. Coopers & Lybrand/Yankelovich, Skelly & White, Inc., "Collaborative Ventures: A Pragmatic Approach to Business Expansion in the Eighties," 1986.

3. W. H. Davidson, "Creating and managing joint ventures in China," California Management Review, Summer, 1987, pp. 77-94.

4. C.A. Frayne and J.M. Geringer, "Self-management training for general managers of international joint ventures," working paper, School of Business Administration, University of Western Ontario, 1989.

5. A.R. Janger, Organization of International Joint Ventures, New York: Conference Board, 1980.

6. J.M. Geringer, Trends and Traits of Canadian Joint Ventures, Ottawa: Investment Canada, 1989 (forthcoming).

CHAPTER 7

CONCLUDING COMMENTS

Joint ventures marrying corporate partners can be a valuable option for many firms and projects, and they might represent a less harrowing option than going it alone. But caution is necessary when selecting partners and forming ventures. It is relatively easy for companies to get married, yet if the courting ritual is not conducted in a thorough manner, divorce is likely. The result - long and acrimonious legal battles, parentless "children," and possibly serious scars - may place a company in a worse competitive position than was the case prior to formation of the venture.

Success or failure of a joint venture depends not only on a venture's underlying strategic rationale, but also on how well the partner companies can work together, despite differences in management styles, strategies, resources and cultures. The effect of such corporate chemistry is difficult to predict and control, but it is a critical consideration since joint venture agreements usually provide each partner with an on-going role in the venture's management. Compatibility of partners beyond mere technical complementarity is an important prerequisite for successful corporate marriage. This is particularly important to keep in mind during the partner selection process, due to the influence this decision may have on the venture's operating policies and performance.

Management of a joint venture often differs from more typical business activities because it might involve a mixture of, and sometimes clashes between, different cultures, thought patterns and attitudes toward competition and cooperation. There is a strong tendency for managers, particularly those without significant prior joint venture experience, to view their prospective ventures as unique. This often translates into a perception that the experience of others has only limited applicability for their own circumstances. However, adamant assertions of the "uniqueness" of a particular joint venture may often be overstated. Although each situation will evidence unique elements, there do seem to be common elements in some, if not all, aspects of the joint venture formation and management process. For this reason, the process of locating suitable partners and forming joint ventures should, when possible, be carried out with the assistance of experienced advisors who are thoroughly familiar with the law and business practices of the target industry and market.

REQUIREMENTS FOR A SUCCESSFUL JOINT VENTURE

The following checklist is intended to assist managers in determining whether the joint venture option should be pursued, as well as whether a particular joint venture should be pursued. These basic questions are often overlooked by managers caught up in the commotion of trying to respond to moves of competitors and to successfully close the deal to form a joint venture.

1. **Are your strategic objectives clearly defined?**

2. **Is this a good project for achieving your objectives?**

3. **Is a joint venture the best option for pursuing this project?**

4. **Are the scope and objectives of the venture clearly focused?**

5. **Will you be significantly better off with this partner?**

6. **Do you understand the short term and long term objectives of your partner, and is this joint venture likely to achieve them?**

7. **Will the partners, collectively, have the necessary skills and resources to satisfy the key success factors for the industry and enable the venture to be economically viable in both the short and the long term?**

8. **Will both sides have the need and commitment to successfully work together over both the short and the long term?**

9. **Has the joint venture been structured, legally and organizationally, so that there is likely to be a payoff for each partner?**

10. **Is the venture's control structure appropriate for the needs and objectives of the partners and the joint venture?**

11. **Is the control structure appropriate for the needs and objectives of the partners and the joint venture?**

12. **Have sources of strategic and operational conflict been anticipated, and clear and detailed means of addressing them been developed?**

13. **Will the agreement permit the venture to successfully adapt to internally and externally induced changes in its operating environment?**

14. **Have the partners agreed on a mutually acceptable method of terminating the joint venture, if and when such a move is necessary?**

Each of the above issues should be carefully examined before the joint venture agreement is concluded. Avoiding a mistake before it happens tends to be much less painful and costly than trying to rectify it after it has occurred. Unless you can honestly respond "yes" to each of the above questions, formation of the joint venture should be a questionable proposition at best.

BIOGRAPHICAL BACKGROUND OF AUTHOR

J. Michael Geringer is Assistant Professor of Policy at the School of Business Administration, The University of Western Ontario, where he teaches undergraduate, graduate and executive development courses in Business Policy and International Business. He received the Ph.D. in Corporate Strategy and International Business from the University of Washington and has spent over a decade studying and working in joint ventures and other cooperative alliances. His joint venture research has involved interviews with over 200 senior executives who formed and managed over 500 joint ventures. He has published a book, Joint Venture Partner Selection: Strategies for Developed Countries, and nearly two dozen articles in various managerial and academic journals. He has also delivered over 50 papers at conferences and workshops throughout Canada, the United States, Western Europe and the Far East.